IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

RONALD O. NORRIS
CYNTHIA D. NORRIS **BK 02-72344-CMS-7**

DEBTORS.

CITIZENS BANK OF WINFIELD, **AP 02-70113-CMS**
AN ALABAMA CORPORATION

PLAINTIFF,

vs.

RONALD O. NORRIS,

DEFENDANT.

MEMORANDUM OF DECISION

This matter was before the court at trial of the creditor/plaintiff bank's suit asking the court to find Ronald O. Norris' debt nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A) and/or to deny the debtor his Chapter 7 discharge pursuant to 11 U.S.C. § 727(a)(4)(A). The court has reviewed the evidence in the context of applicable law and finds the bank has met its burden of proving that the Norris debt should be **NONDISCHARGEABLE** under §523(a)(2)(A). However, the plaintiff failed to prove all the elements necessary to deny Norris' discharge pursuant to §727(a)(4).

FINDINGS OF FACT

On November 5, 2002 Citizens Bank of Winfield (Citizens Bank) filed this adversary

proceeding complaint (AP 02-70113, AP Doc. 1) against its former customer Ronald O. Norris. On February 18, 2004 Citizens Bank amended the complaint (AP Doc. 35). Norris had filed this Chapter 7 bankruptcy case August 8, 2002.

Count One of the complaint alleged that the deficiency balance due on Norris' real estate loan from Citizens Bank should not be discharged pursuant to 11 U.S.C. § 523(a)(2)(A) (as money obtained by false pretense, false representation, or actual fraud).

Count Two alleged that the debtor should be denied his Chapter 7 discharge pursuant to 11 U.S.C.§ 727(a)(4) (for knowingly and fraudulently making a false oath or account , in or in connection with a bankruptcy case). This claim arose out of the debtor's sworn testimony concerning a 1986 Toyota pickup truck at his Section 341 meeting of creditors.

Count Three of the complaint is also under § 727(a)(4), and stems from other Norris 341 testimony about a 1991 Chevrolet truck.

The court heard testimony and received exhibits at a trial on the complaint held November 22, 2004.[1] The court will state the record facts relating to each count separately.

Count One

Count One relates to a commercial real estate loan Citizens Bank made to the debtor in 2001. Norris applied for the loan, to purchase a house referred to as the Foothills property which he proposed to remodel and sell. Robert L. Carothers, senior vice president and lending officer at Citizens Bank, testified that Norris had then been a customer for 10 to 15 years and had

[1] Norris chose to appear at the trial pro se, following the court's continuation of the original trial setting to allow him to replace his former attorneys. The debtor' trial counsel withdrew from the representation without objection by the defendant. Norris elected not to employ new counsel, despite the opportunity afforded by the continuation.

received previous home construction loans from the bank. There had been no prior problems with Norris' loans. In August of 2001, Norris described to the bank his plans to purchase and renovate the Foothills property. Proposed renovations included adding a room and a carport to an existing house. The bank made a commercial loan to Norris to buy the real estate, pay off an existing mortgage, and construct the additions described to Carothers. On Friday, August 24, 2001 Citizens Bank disbursed the loan proceeds to Norris (Plaintiff's Exhibit 20).

Norris also had a business checking account with the bank. Plaintiff's Exhibit 33 shows the debtor had opened Account No. 01119222 in the name of Ronald O Conell Norris d/b/a R. O. Norris Construction, opened in 1999. Plaintiff's Exhibit 20, shows the $25,500.00 in loan proceeds was credited to Norris' business account on Monday, August 27, 2001, and that $7,615.97 was applied to a loan at the bank; and $14,500.00 was used to satisfy a mortgage on the Foothills property. Title to the real estate was taken in the name of Norris and his wife (Plaintiff's Exhibit 21). A mortgage was granted to the bank on the real estate (Plaintiff's Exhibit 22).

October 24, 2001 Norris requested more money from the bank to complete the remodeling of the Foothills property. Plaintiff's Exhibit 23 is a written description Norris provided to Citizens Bank setting out the work remaining to be done. Citizens Bank loaned the debtor another $26,000.05, and the mortgage was refinanced for $48,999.95. Plaintiff's Exhibit 27 shows a disbursement of the refinancing on October 30, 2001, in which $26,000.05 was credited to Norris' business checking account on October 31, 2001. Another mortgage was recorded on the Foothills property as shown by Plaintiff's Exhibit 28.

M. L. Hamric, a retired employee of Citizens Bank, lived on the same street as the

Foothills property. Hamric had continued to do appraisal work for the bank in retirement. He testified that as of August 9, 2001, he had appraised the Foothills property at $16,000.00. Hamric estimated that the improvements Norris proposed would increase the value to $56,000.00 (Plaintiff's Exhibit 29).

He further testified that he drove by the property daily and that work on the house had stopped by November 14, 2001, that Norris did no more work after that date. It was Hamric's judgment that only an approximate 30% of the proposed work had been completed by that time.

Following Norris' bankruptcy, the bank foreclosed on November 11, 2002, and sold the Foothills property for $29,000.00. Foreclosure sale left a principal balance of $46,856.96 still owing as a deficiency on the loan account.

Plaintiff's Exhibits 34-38 are copies of statements and cancelled checks on Norris' business account where Citizens Bank deposited the loan proceeds. These exhibits reflect all checks written and deposits made from August 1, 2001 through December 31, 2001.

Plaintiff's Exhibits 34-38 show a total of $59,092.56 deposited into the business checking account August 1, 2001 through December 31, 2002, most of the money coming from the bank's loans. The total included $25,500.00 credited on August 27, 2001, the initial loan from Citizens Bank on the Foothills property; and the additional $26,000.05 credited as of October 31, 2001 after the refinancing. So $51,500.05 of the $59,092.56 in deposits came from the Citizens Bank real estate loans.

During these five months, the statements also reflect approximately $2,005.00 in bank charges for returned checks and service charges. Excluding these returned check/service charges, the statements show a total of approximately $59,559.00 in checks written on the

account. Plaintiff's Exhibit 16 is a copy Norris' deposition in this lawsuit. Plaintiff's Exhibit 39 is a summary of checks that Norris stated in his deposition were not related to the Foothills remodeling; but, nevertheless, were written on the business account. Exhibit 39 reflects that Norris identified $33,832.72 in checks, more than half the debits, as unrelated to the remodeling. These figures show that only $25,260.00 in checks, less than half the debits in this period, were written for the Foothills project.

The evidence shows details of the $33,832.72 in unrelated withdrawals. The original loan, for example, was made Friday, August 24, 2001 as reflected in Plaintiff's Exhibits 19 and 20. That same day, Norris wrote a check for $4,357.44 to McClusky Lumber (Check No. 1208, Plaintiff's Exhibit 34). Plaintiff's Exhibit 34 shows that Norris' checking account was overdrawn that day; while Plaintiff's Exhibit 39 showed the McClusky payment was was not related to the Foothills property.

The initial $25,500.00 loan proceeds were credited to Norris' checking account on Monday, August 27, 2001, then the McClusky Lumber check cleared the bank August 28, 2001 (Plaintiff's Exhibit 34).

Norris admitted that approximately $8,567.00 in checks written on the account from August 24 to August 31, 2001 were not related to the Foothills remodeling (Exhibit 39). These included the following: $1,325.21 for his riding lawn mower (Check No. 1217); $1,151.06 for a gun (Check No. 1235); $234.84 to his sister-in-law (Check 1211); and checks for numerous other personal expenditures. Several of these checks were written when the account was still overdrawn, and appeared to have anticipated the deposit of the loan proceeds. In contrast to the $8,567.00, only $703.00 appears to have been spent on the Foothills remodeling between the

August 27 deposit/credit, and the August 31 closing date for the bank statement.

During September, Plaintiff's Exhibit 39 reflects that approximately $6,832.00 in checks written which were unrelated to the Foothills project. They included $106.53 for arrows on September 1, 2001 (Check No. 1239); $912.64 for a personal loan payment on September 4, 2001 (Check No. 1247); $624.02 for Norris' car payment on September 6, 2001 (Check No. 1252); and $353.00 for a citizens band radio on September 13, 2001 (Check No. 1303).

By September 30, 2001, the checking account was overdrawn again (Plaintiff's Exhibit 35). At that point, approximately $8,062.00 had been spent on remodeling the house, but an approximate $15,399.00 in checks had been written for unrelated expenses. Nevertheless, Norris continued to write checks during October; and by October 30, 2001, the account was $6,675.98 overdrawn (Plaintiff's Exhibit 36). Of these overdraft checks, $4,430.00 was spent on the remodeling job, and $2,210.00 went for other things.

Citizen's Bank refinanced the construction/real estate loan October 30, 2001, and $26,000.05 in new money was credited to the checking account October 31, 2001. The next day, Norris wrote checks for $2,250.00 for rent of his residence (Check No. 1360), and $171.00 for arrows (Check No. 1363). November 8, 2001 he paid his personal car payment in the amount of $617.83 (Check No. 375), and wrote a $220.00 check for bow accessories (Check No. 1377). November 12, 2001, he wrote a $487.55 check for a hunting light (Check No. 1400).

Hamric had testified that work stopped at the Foothills project November 14, 2001, and never resumed. Nevertheless, on November 19, 2001, Norris wrote a $5,692.50 check (Check No. 1429) for siding on another job, unrelated to the unfinished Foothills project work. By November 21, 2001, the account was again overdrawn (Plaintiff's Exhibit 37).

Count Two

Count Two of Citizens Bank's complaint is based Norris' testimony about a 1986 Toyota pickup truck given under oath at his Section 341 meeting of creditors. Norris had financed the purchase of the truck through Citizens Bank on May 7, 2001(Plaintiff's Exhibits 6, 7, 8 and 9).

At the 341 meeting, the debtor testified that nothing had been stolen or removed, or was missing from the 1986 Toyota since it had been financed by Citizens Bank (Plaintiff's Exhibit 16 at page 34-35). The bank later took Norris' deposition on March 20, 2003 and excerpts of the deposition were admitted as Plaintiff's Exhibit 16. At deposition, Norris stated that he put a set of mud-grip tires on the Toyota pickup in the fall of 2001 for deer hunting season. After deer season was over in February of 2002, he took the mud-grip tires off again, and replaced them with the tires that were on the truck when he bought it. He further testified that in July of 2002 he gave the mud-grip tires to Greg Youngblood for no consideration (meaning Youngblood neither paid Norris, nor did Norris owe Youngblood any debts). There was no evidence on the value of either set of used tires.

Norris filed Chapter 7 bankruptcy on August 8, 2002. Based on the 341 and deposition testimony, Citizens Bank asserted he should be denied a discharge pursuant to 11 U.S.C. § 727(a)(4) for a false oath in bankruptcy.

Count Three

This count of the complaint is also based on other Norris testimony at the Section 341 meeting, this time about a 1991 Chevrolet work truck. Citizens Bank had financed the purchase of this vehicle in February of 2001 (Plaintiff's Exhibit 1, 2, 3, 4 and 5).

Norris again testified at the 341 meeting that nothing had been stolen or removed, or was

missing from the 1991 Chevrolet truck after the bank financed it (Plaintiff's Exhibit 16 at p. 35).

At the March 20, 2003 deposition, Norris testified that he had installed what was referred to as a roof rack or tool rack on the Chevrolet truck after he purchased it and after Citizens Bank financed it. He also testified that he removed the rack in July of 2002 because it was his own personal tool rack. There was no evidence as to how this rack had been attached to the vehicle, or as to its value.

Citizens Bank also asserted that the debtor's discharge should be denied under Section 727(a)(4) as a result of this 341 meeting and deposition testimony.

Following the close of evidence and testimony at the hearing, the court took the dispute under submission for a decision.

CONCLUSIONS OF LAW

This court has jurisdiction of Ronald O. and Cynthia D. Norris' Chapter 7 liquidation case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this lawsuit, a core bankruptcy proceeding arising under 11 U.S.C. §§ 523(a)(2)(A) and 727(a)(4)(A), pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court, pursuant to 28 U.S.C. § 157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, as amended July 17, 1984.

I.

Citizens Bank proved at trial that debtor Ronald O. Norris induced a commercial loan by misrepresentation. Consequently, the unpaid balance of loan No. 630672 is nondischargeable under Section 523(a)(2)(A).

A. A creditor seeking to have a debt declared nondischargeable under Section 523(a)(2)(A) must prove the elements of common law fraud/misrepresentation by a preponderance of the evidence.

11 U.S.C. § 523(a) provides 18 statutory bases or causes of action by which an aggrieved creditor may have its prepetition debt declared nondischargeable in bankruptcy. All are based on the debtor's misconduct toward certain individual creditors, or on policy goals making certain debts nondischargeable in the public interest.

Section 523(a)(2)(A) states the following:

> **Exceptions to discharge.**
>
> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt— ... (emphasis added)
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; ...

The Supreme Court has held that a finding of Section 523(a)(2)(A) nondischargeability requires proof of the long-settled elements of common law fraud, as defined by courts in 1978 when Congress enacted the Bankruptcy Code. See Field v. Mans, 516 U.S. 59, 72-73 (1995).

As stated subsequently by the Eleventh Circuit, those elements include

> Courts have generally interpreted § 523(a)(2)(A) to require the traditional elements of common law fraud. A creditor must prove that: (1) the debtor made a false representation to deceive the creditor, (2) the creditor relied on the misrepresentation, (3) the reliance was justified, and (4) the creditor sustained a loss as a result of the misrepresentation.

See Securities and Exchange Commission v. Bilzerian (In re Bilzerian), 153 F.3d 1278, 1281 (11th Cir. 1998).

The justices' Field opinion listed common law fraud elements as described in both the Restatement (Second) of Torts (1976) and Prosser's Law of Torts in 1978. Both treatises required only a relatively subjective "justifiable and actual" standard for the creditor's reliance on a fraudulent

representation. See Field v. Mans, 516 U.S. at 73-75. Such reliance can be "justifiable" even if further investigation would have shown the representation to be false:

> The section (of the Restatement) on point dealing with fraudulent misrepresentation states that both actual and "justifiable" reliance are required. ... The Restatement expounds upon justifiable reliance by explaining that a person is justified in relying on a representation of fact "although he might have ascertained the falsity of the representation had he made an investigation. ... Significantly for our purposes, the illustration is given of a seller of land who says it is free of encumbrances; according to the Restatement, a buyer's reliance on this factual representation is justifiable, even if he could have "walk[ed] across the street to the office of the register of deeds in the courthouse" and easily learned of an unsatisfied mortgage.

Field v. Mans, 516 U.S. at 70.

In contrast, the language Congress chose for Section 523(a)(2)(B) on fraud by written statement specifically requires "reasonable reliance," a more objective standard.

The elements of a claim under Section 523(a)(2)(A) are the following:

(1) the debtor made a false statement with the purpose and intention of deceiving the creditor; (2) the creditor relied on such false statement; (3) the creditor's reliance on the false statement was justifiably founded; and (4) the creditor sustained damage as a result of the false statement. See Fuller v. Johannessen (In re Johannessen), 76 F.3d 347, 350 (11th Cir. 1996).

To succeed in a Section 523(a)(2)(A) nondischargeability action, the plaintiff must prove all the elements of common law fraud by a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279 (1991).

B. In this case, Citizens Bank has met its burden of proving that Norris' deficiency balance on the "Foothills" loans should be nondischargeable under § 523(a)(2)(A).

The court will analyze the fraud elements which must be proven under § 523(a)(2)(A) in the context of the facts in this lawsuit.

(1) Norris made made a false statement/representation with the purpose and intention of deceiving Citizens Bank.

In most cases, the fraudulent intent needed to turn a misrepresentation or false statement into actionable common law fraud must be deduced from the totality of the circumstances and the facts by the Bankruptcy Court. As stated in Stifter v. Orsine (In re Orsine), 254 B.R. 184, 188 (N.D. Ohio, 2000)**:**

> Any inquiry as to whether a person acted fraudulently or otherwise wrongly by giving a false representation, necessarily entails an examination of that person's state of mind. ... When determining whether such elements are met, a bankruptcy court is to consider all the relevant facts and circumstances of the case, as it is highly unlikely that a debtor would ever actually admit they knowingly intended to deceive a creditor. ...

Citizen's Bank funded the original loan for the remodeling of the Foothills property Friday, August 24, 2001. That same day, Norris wrote a check for $4,357.44 to McClusky Lumber (Check No. 1208, Plaintiff's Exhibit 34), which he admitted was not related to the property to be remodeled with the Citizen's Bank loan. Plaintiff's Exhibit 34 also showed that Norris' business checking account was overdrawn until the $25,500.00 loan for the Foothills remodeling job was credited to the account, Monday, August 27, 2001. By August 31, 2001, Norris had spent only $703.00 of the $25,500.00 on the remodeling work, compared to $8,567.00 he had spent on matters unrelated to the Foothills project.

Norris went back to Citizens Bank at the end of October of 2001 asking for more funds, allegedly to be used to complete the remodeling job. The day after the additional $26,000.05 loan was credited to his overdrawn checking account, he again began writing checks for things other than the remodeling, including $2,250.00 for his rent at his residence (Check No. 1360); and a $5,692.50 check written November 19, 2001 for siding on a project other than the Foothills property, Check

No. 1429).

Courts have generally applied a broad definition to what constitutes "false pretenses, a false representation, or actual fraud" in the meaning of § 523(a)(2)(A). It can even include a material omission:

> Failure to disclose information may be characterized as a misrepresentation within the meaning of Section 523(a)(2)(A). ... In addition, the court can infer an intent to deceive from the totality of the circumstances.

See Bracco v. Pollitt (In re Pollitt), 145 B.R. 353, 355 (Bankr. M.D. Fla. 1992).

Another Florida Bankruptcy Court judgment also held that a debtor had procured a loan by false pretenses in Eisinger v. Zito (In re Eisenger), 304 B.R. 492, 497-98 (Bankr. M.D. Fla. 2003):

> The Debtor incurred the debt to the Zitos (creditors) under false pretenses or by making a false representation.
>
> > "A 'false pretense' involves implied misrepresentation or conduct intended to create and foster a false impression." In re Guy, 101 B.R. 961, 978 (Bankr. N.D. Ind. 1988). "[W]hen the circumstances imply a particular set of facts, and one party knows the facts to be otherwise, that party may have a duty to correct what would otherwise be a false impression. This is the basis of the 'false pretenses' provision of Section 523(a)(2)(A)." In re Malcolm, 145 B.R. 259, 263 (Bankr. N.D. Ill. 1992) (citing In re Dunston, 117 B.R. 632, 639-41 (Bankr. D. Colo. 1990)).
> >
> > A debtor's silence regarding a material fact may constitute a false representation actionable under section 523(a)(2)(A).(Citations omitted) For purposes of section 523(a)(2)(A), a "misrepresentation" denotes "not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth." (Citations omitted).
>
> ... "A false pretense involves an implied misrepresentation or conduct intended to create or foster a false impression." In re Zeller, 242 B.R. 84, 87 (Bankr. S.D. Fla. 1999).

See also Hanft v. Church (In re Hanft), 315 B.R. 617, 622 (S.D. Fla. 2002); John Deere Co. v. Broholm (In re Broholm), 310 B.R. 864, 872 (Bankr. N.D. Ill. 2004); and McCain v. Fuselier (In re Fuselier), 211 B.R. 540, 543-44 (Bankr. W.D. La. 1997).

In this case, Norris represented to the bank, when he obtained loans in both August and

October of 2001, that proceeds would be used to remodel the Foothills property, improving the value of the bank's collateral. Carothers and Hamric estimated that if Norris had, in fact, used the proceeds as proposed, the real estate/collateral's value would have increased from $16,000.00 to $56,000.00. Sale at that value would have been more than enough to repay Citizens Bank.

Exhibits 34-38, showing Norris's cancelled checks; and Exhibit 39 identifying checks Norris admitted were unrelated to the Foothills remodeling show that he did not intend to use these monies as he represented to the bank. The facts in evidence reveal a pattern showing that Norris intended to use the loan proceeds to make payments on other construction jobs, and to fund his personal living expenses and recreational activities, as well as for the remodeling. There is no evidence Norris disclosed his real intentions for use of the money to the bank.

The court must deduce that Norris' representations to the bank in August and October of 2001 were both false and made with the intention of deceiving the bank in the meaning of Section 523(a)(2)(A) fraud.

(2) In the circumstances, the bank's reliance on Norris' misrepresentations was justifiably founded.

Norris had been a Citizens Bank customer of the bank for 10 to 15 years by August of 2001, and the bank previously financed home construction loans for him. Prior to this dispute, there had been no problems with his loan accounts. Citizen's Bank's reliance on Norris's statement that he was going to use the funds to remodel the Foothills property and repay the loan was justifiable under these facts.

(3) Citizens Bank sustained at least $46,856.96 in damages as a result of the false statement/misrepresentation.

The testimony reveals that the Foothills property was sold at foreclosure for only $29,000.00

on November 11, 2002, following Norris' bankrukptcy. Including accrued interest and fees, the sale left an unpaid deficiency balance of $46,856.96 at that time. Additional fees, interest, and costs have accrued since then. If the loan proceeds had been used to remodel the Foothills property, rather than for other projects and personal expenditures, the bank would not have suffered so great a loss.

Norris' debt on loan #630672 is nondischargeable in bankruptcy, since the bank met its burden of proof under Section 523(a)(2)(A).

II.

The bank failed to offer sufficient evidence for the court to deny Norris his overall Chapter 7 discharge pursuant to Section 727(a)(4)(A).

A. A plaintiff faces a heavy burden in proving the egregiously wrongful conduct required to deny a debtor his discharge under U.S.C. § 727(a)(4).

Denying a debtor's overall discharge in Chapter 7 bankruptcy under 11 U.S.C. § 727 has long been considered such a drastic and punitive remedy that the statutory elements are construed strictly against the objector. For a Section 727 nondischargeability judgment means that the debtor is completely denied bankruptcy's "fresh start" as to all prepetition debt, whether all the debts are legally dischargeable or not.

The nondischargeability causes of action under Section 727 guard the integrity of the bankruptcy court system as a whole by punishing debtors' gross dishonesty, omission, and failure to disclose. Section 727 punishes fraud on the court, rather than simply protecting the interests of individual creditors. Section 727 safeguards the court's ability to serve the interests of all parties enforcing the Bankruptcy Code as Congress intended.

Citizens Bank has contended Norris should be denied his discharge pursuant to Section 727(a)(4) because he failed to disclose under oath at his Section 341 meeting that he had removed

accessories from two different trucks in which the bank held collateral interests. Section 727(a)(4)(A) provides the following:

(a) The court shall grant the debtor a discharge unless -- ...

(4) the debtor knowingly and fraudulently, in or in connection with the case –

(A) made a false oath or account; ...

Courts considering the "false oath" bar to discharge have generally required objecting plaintiffs to prove the following:

(1) that the debtor made the statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement was material to the bankruptcy. ...

See Overly v. Guthrie (In re Guthrie), 265 B.R. 253, 262 (Bankr. M.D. Ala. 2001).

As stated in the Guthrie case, the Eleventh Circuit Court of Appeals emphasized in Chalik v. Moorefield (In re Chalik), 748 F.2d 616 (11th Cir. 1984) and Swicegood v. Ginn, 924 F.2d 230 (11th Cir. 1991) that the sworn statement must be both false and material to the bankruptcy case. See also Raiford v. Abney (In re Raiford), 695 F. 2d 521, 522 (11th Cir. 1983) (The conduct proscribed by Section 727(a)(4) is "identical" to that outlawed as felony bankruptcy fraud under 18 U.S.C. § 152 of the federal criminal code. Though "... Both provisions come into play only if a debtor issues a false statement in relation to his bankruptcy petition. ...")

Under Fed. R. Bankr. P. 4005, the objecting party has the burden of proving the elements of Section 727(a)(4)(A) nondischargeability. A plaintiff may be called upon to explain the allegedly false statement or omission only after the objector establishes an initial, prima facie case for discharge denial. See Chalik, 748 F.2d at 619; and Lubman v. Duncan (In re Duncan), 318 B.R. 648, 652

(Bankr. E.D. Va. 2004).

B. Based on the facts offered in support of Counts II and III, Citizens Bank failed to establish a sufficient case under Section 727(a)(4) to deny Norris his Chapter 7 discharge.

Although Citizens Bank introduced voluminous evidence in this case, the facts adduced in this record fall short of proving that Norris should be denied his Chapter 7 discharge for false oath under Section 727(a)(4).

No one disputed that the initial statements made about the Toyota pickup and the Chevrolet work truck were made under oath. That is the purpose of the Section 341 meeting of creditors – to allow creditors to question the debtor in person and under oath as to issues surrounding his bankruptcy filing, and his financial condition. The bank later deposed Norris under oath as well. So the bank established the first (and easiest) element for proof under Section 727(a)(4).

Norris did not dispute that he had answered "no" to the 341 questions about whether anything had been removed from either truck after they became the bank's collateral. The debtor did not dispute that later, in his sworn deposition, he stated that he had removed mud grip tires from the Toyota and reinstalled tires that came with the truck. He did not dispute that he stated in the deposition that he had removed a personal tool rack he had placed on the Chevrolet collateral.

So the bank also established that, textually, Norris had answered "No" under oath; and subsequently, answered "Yes" under oath to the same questions about the same trucks in two different record proceedings in bankruptcy. It is clear that both sets of responses cannot be factual, since they appear to be opposed. To that extent one or the other of the statements must be unfactual, or technically false. Norris, in his trial testimony, appeared to accept the latter version as correct.

However, the bank offered no objective evidence from which this court might deduce a fraudulent intent on Norris' part in making the statements in his bankruptcy case. For that reason

alone, this court cannot deny his discharge under 727(a)(4).

Further, even if court assumed that the first four elements of the cause of action had been met, the bank's claims in Counts II and III would still fail on the issue of materiality. For the statement must be both false and material to the bankruptcy under longstanding interpretations of the federal 727 cause of action.

There is no evidence that the used tires and tool rack were material to the administration of Norris' case.

Citizens Bank has failed to meet its burden of proving that the debtor should be denied his overall discharge pursuant to 11 U.S.C. § 727(a)(4).

CONCLUSION

Consequently, judgment must be entered **IN FAVOR OF THE PLAINTIFF**, Citizens Bank of Winfield, and **AGAINST THE DEFENDANT,** Ronald O. Norris, on the Count I claim that Norris' remaining debt to the bank should be nondischargeable under 11 U.S.C. § 523(a)(2)(A). However, judgment must be entered **IN FAVOR OF THE DEFENDANT** and **AGAINST THE PLAINTIFF** on Counts II and III seeking to deny the debtor's Chapter 7 discharge pursuant to 11 U.S.C. § 727(a)(4).

An order, consistent with these findings pursuant to Fed. R. Bankr. P. 7052, will be entered separately.

DONE and ORDERED this April 26, 2005.

/s/ C. Michael Stilson

C. Michael Stilson

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
WESTERN DIVISION

IN RE: **BK 03-72672-CMS-12**

JULIAN D. WASHBURN

DEBTOR

MEMORANDUM OF DECISION

This matter is before the court on a Motion for Relief from the Automatic Stay or in the Alternative to Dismiss filed by First South Farm Credit. The Court has heard testimony and the arguments of the parties and finds that the Motion for Relief from the Automatic Stay is due to be **GRANTED** and the Motion to Dismiss is to be **DENIED** based on the following facts.

FINDING OF FACTS

The debtor Julian D. Washburn (debtor) filed his Chapter 12 bankruptcy petition August 22, 2003. His proposed plan was filed January 26, 2004 (Doc. 21). The hearing on confirmation of the debtor's plan and the objection to confirmation filed by First South Farm Credit (First South) was held March 10, 2004. Extensive testimony was taken concerning the feasibility of the debtor's plan. Even using the debtor's projections of income, the court acknowledged that the debtor's plan was only marginally feasible, but confirmed the plan over the objection of First South. The Order of Confirmation was signed May 18, 2004 (Doc. 34) and entered May 21, 2004.

The debtor's plan, as confirmed, in paragraph number 33 provided that the debtor would pay

First South annual mortgage payments of $60,000.00 per year with the first payment being due June 15, 2004. All subsequent mortgage payments would be due April 1 of each year. The debtor paid the first $60,000.00 payment for June of 2004. It was agreed that the debtor had not paid the April, 2005 payment.

Paragraph 38 of the debtor's confirmed plan provided the following payments were to be made to the Chapter 12 Trustee:

December 31, 2004	$129,300.00
December 31, 2005	$105,841.00
December 31, 2006	$105,841.00
December 31, 2007	$170,132.00
August 22, 2008	$170,132.00

It was stipulated by the parties that no payments were made to the Chapter 12 Trustee.

First South filed its motion for relief from the automatic stay (Doc. 44) on January 26, 2005. A hearing was scheduled on the motion February 24, 2005 and was continued by agreement. Testimony was taken on the motion April 12, 2005. It was debtor's testimony that in September of 2004 he had approximately 200,000 pounds of catfish killed as a result of Hurricane Ivan and therefore he was unable to make his December 31, 2004 plan payment. Debtor testified that these fish would have been worth approximately $.70 per pound. He testified that he did not report this loss to First South and it was First South's testimony that they only learned about the loss in January of 2005. Paragraph 40 of debtor's confirmation order provided that payments under the plan could be delayed for twelve months in the event Hale County was designated a disaster area. Paragraph 40(b) required that the debtor notify the Court, Chapter 12 Trustee, and all creditors of the exercise of this option in writing prior to the suspension of payments and gave creditors ten days to object to the proposed suspension. No written notification was given by the debtor. It was agreed by all

parties that Hale County was declared a disaster area by the President following Hurricane Ivan.

There was no insurance available to cover the loss of the catfish. Debtor did testify that he would be eligible for payment for damages done to his property, but these claims would only cover damages to his building, roads, and levies.

At the hearing on the motion for relief from the automatic stay the debtor testified that he could bring his plan current by September of 2005 and comply with the other terms of the plan in the remaining period of time. The debtor again made projections on his ability to produce catfish and submitted testimony concerning the amount of catfish on hand at this time which were ready for harvesting.

The debtor testified that he had three ponds that could be harvested in approximately thirty days. Pond N13, he projected, would yield 20,000 pounds; pond N5 would yield 50,000 pounds; and pond N6 would yield 100,000 pounds. This total of 170,000 pounds at what was testified to be $.70 per pound, would yield a gross amount of $119,000.00. The debtor presented no evidence of the amount of expenses required over the next month for these fish.

The debtor further testified that there were fish which could be harvested in August of 2005. He testified that pond N3 would yield 40,000 pounds and pond N7 would yield 200,000 pounds. This would yield a total of 240,000 pounds and at $.70 per pound would gross $168,000.00. Debtor projected sales but did not project expenses, although he states that expenses would be higher than last year since he anticipates higher feed bills.

Movant's Exhibit A recorded the expenses for last year for various months. Assuming that May, 2005 expenses were approximately the same as June, 2004, and that the remaining months were the same, then expenses through August, excluding payments on principal, would total

$91,782.00. This would leave a net of $76,218.00 when the August ponds were harvested.

At another point in his testimony, the debtor stated that in August four ponds would be ready to sell. This apparently included partial sanes, as well as a full harvest. Pond B9 was expected to yield 20,000 pounds; pond B10 was projected to yield 40,000 pounds; pond N7 was projected to yield 140,000 pounds (rather than 200,000 pounds as previously testified to); and pond N12 was projected to yield 15,000 pounds. This would give a total of 215,000 pounds and at $.70 per pound would yield a gross of $150,500.00. With the same estimated expenses of $91,782.00, there would be a net of $58,718.00 in August 2005.

Using the debtor's highest estimates of yield and last year's expenses with no expenses for the projected harvest in thirty days, there would be a maximum of $195,218.00 the debtor could accumulate between the hearing and September 2005. $189,300.00 is necessary to bring the case current by September 2005.

Another payment would then be due December 31, 2005 in the amount of $165,841.00.

First South's loan to the debtor was secured by debtor's real estate, equipment, and inventory. Debtor presented evidence that in 2003 the real estate and equipment were appraised for $724,000.00. Claims 7 and 8 reflect a total balance due to First South of approximately $1,191,540.00. It was debtor's testimony that his fish inventory in its various stages of growth was currently worth 1.073 million dollars (Debtor's Exhibit 5).

Movant's Exhibit A shows the debtor's sell of fish inventory from June 2004 through December 2004 totaled $283,592.93. This included $102,155.95 sold during December, but nothing was paid to the Chapter 12 Trustee for the December, 2004 plan payment, which was due December 31, 2004 in the amount of $129,300.00. The only payment the Debtor made during 2004 was the

$60,000.00 payment to First South in June of 2004. In addition to the $283,592.93 of fish sold, $140,000.00 of fish inventory was lost in the hurricane. This gives a total of $423,592.93 in fish inventory sold or destroyed from June 2004 through December 2004. This accounts for approximately 40% of what Debtor testified was the current value of the fish inventory. From this fish inventory only $60,000.00 was paid to First South in June of 2004.

CONCLUSIONS OF LAW

Pursuant to 11 U.S.C. Section 362(d)(1), the automatic stay can be lifted on the request of a party in interest after notice and a hearing "for cause, including the lack of adequate protection of an interest in property of such party in interest ...". The moving party has the initial burden of persuasion that it has demonstrated "cause" for the stay to lift. See Schneiderman v. Bogdanovich (In re Bogdanovich), 292 F.3d 104 (2nd Cir. 2002) (burden is on the moving party to make an initial showing of cause absent which the request for relief must be denied.). First South showed that 200,000 pounds of its collateral had been lost, that the debtor had failed to make his first payment of $129,300.00 to the Chapter 12 Trustee, and had failed to make his April 2005 $60,000.00 mortgage payment.

Having made its initial prima facia showing of cause, the burden then shifts to the debtor. Pursuant to 11 U.S.C. Section 362(g) the debtor has the burden of proving that the creditor's property is "adequately protected". Pursuant to the terms of the confirmation order the debtor was to pay $681,246.00 to the Chapter 12 Trustee through August of 2008, plus $300,000.00 in mortgage payments direct to First South between confirmation and April of 2008. $60,000.00 was paid, leaving $921,246.00 to be paid by August of 2008.

The evidence was that the catfish serving as collateral for First South's loan were uninsured.

11 U.S.C. Section 361(1) provides that the debtor can provide adequate protection by periodic cash payments to the creditor. The Debtor proposes to make cash payments to First South by selling fish and making a payment in August in order to bring his plan current, and continue to sell fish in the future pursuant to the plan. The effect would be paying the $921,246.00 due by August of 2008 over a shorter period of time. The only evidence of the debtor's ability to do this was his bare assertions that he can make up this loss by pushing the catfish harder by giving them more feed. There was no evidence of how much this would increase production of catfish or evidence of how much it would cost. The evidence does show that First South received $60,000.00 over a one year period and that catfish, which served as collateral to their loan, valued at approximately $423,593.00 had been sold or destroyed. There was no insurance on the catfish lost to the hurricane and no evidence that the debtor can, in fact, make up this loss. If everything had gone right, the debtor's ability to make the payments called for under the terms of his plan was close. An uninsured loss of what the debtor projected to be $140,000.00 is more than his catfish operation can bear. His assertions that he can make up this loss by pushing the catfish harder by giving them more feed, without evidence of what this would yield or cost, is not evidence that the creditor's interest is adequately protected.

For this reason First South's motion for relief from the automatic stay is due to be **GRANTED.** An order consistent with these findings will be entered separately.

DONE and ORDERED this June 8, 2005.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

RICKY LYNN HUDSON, and **BK 04-71951-CMS-13**
SANDY M. HUDSON,

DEBTORS.

MEMORANDUM OF DECISION

This matter was before the court on creditor Mitsubishi Motor Credit of America's motion to allow its late claim to be paid through Ricky Lynn Hudson and Sandy M. Hudson's Chapter 13 plan. The court **DENIED** MCCA's claim in an order (Doc. 48) entered May 18, 2005. The following memorandum memorializes the court's rationale for the order.

FINDINGS OF FACT

Debtors Ricky Lynn Hudson and Sandy M. Hudson (Hudsons) filed a petition for relief under Chapter 13 of the Bankruptcy Code on June 30, 2004. (Doc. 1) The Hudsons listed creditor Mitsubishi Motor Credit of America (MMCA) in the schedules filed with their petition. The schedules listed MMCA's collateral as a 2002 Mitsubishi Diamante. The Hudsons schedules listed MMCA's debt at $25,409.90 secured by a car they hoped to value at only $12,000.00 for purposes of their Chapter 13 plan. On July 2, 2004, notice was sent to all scheduled creditors that the Hudsons' Section 341 meeting of creditors would be held August 13, 2004, and that the claims bar date would be November 11, 2004. (Docs. 6 and 11).

MMCA was also sent notice of the Hudsons' motion to value its collateral (Doc. 8) and of the hearing on the motion set on August 24, 2004 (Doc. 9). MMCA did not appear at the hearing, nor respond to the motion in any way. On September 7, 2004, the court entered an order setting the replacement value of the vehicle at $12,000.00. (Doc. 24) The court entered an order confirming the debtors' Chapter 13 plan on October 20, 2004. (Doc. 29) On October 22, 2004, MMCA was sent a copy of the confirmation order. (Doc. 30) The plan, as confirmed, provided for payments of $250.00 a month to MMCA for the $12,000.00 value of its secured claim, plus 6 per cent interest, upon the creditor's filing a properly perfected proof of claim. Unsecured creditors received no payments under the plan.

MMCA failed to file a proof of claim by the November 11, 2004 bar date. (Doc. 40).

On January 13, 2005, MMCA filed a notice of appearance and request for notice in the Hudsons' Chapter 13 case. (Doc. 40) Subsequently, MMCA filed a **MOTION TO ALLOW LATE CLAIM** (Doc. 41) requesting that its claim be "deemed as properly filed and to be paid by and through the Chapter 13 Case." On April 22, 2005, MMCA filed a letter brief arguing that the debtors' own pre-bar-date treatment of Mitsubishi constituted an "informal proof of claim"allowing the court to allow a late-filed claim. (Doc. 46)

At the May 10, 2005 hearing on the motion, MMCA stipulated there were no disputes as to the record facts – that MMCA was scheduled and did receive notice. Neither MMCA nor the debtors offered any evidence at the hearing. The court stated its intention to **DENY** the motion from the bench, and entered its written order doing so (Doc. 48) on May 18, 2005.

CONCLUSIONS OF LAW

This court has jurisdiction of Ricky Lynn and Sandy M. Hudson's Chapter 13 case pursuant

to 28 U.S.C. § 1334(a). The court has jurisdiction of this contested matter, a core bankruptcy proceeding arising under 11 U.S.C. § 502 as listed at 28 U.S.C. § 157(b)(2)(B), pursuant to 28 U.S.C. § 1334(b).

Under 11 U.S.C. § 502(a), claims filed in a bankruptcy case are "deemed allowed" unless a successful objection is made. Section 502(b) requires a court to determine the amounts of contested claims and allow them except for nine exceptions. Section 502(b)(9) states the court "shall allow" claims, "except to the extent that– (9) proof of such claim is not timely filed, ..." Fed. R. Bankr. P. 3002 (c) defines "timely":

> **Time for Filing.** In a chapter 7 liquidation, chapter 12 family farmer's debt adjustment, or chapter 13 individual's debt adjustment case, a proof of claim is timely filed if it is filed not later than 90 days after the first date set for the meeting of creditors called under § 341(a) of the Code, ... (emphasis added)

The November 11, 2004 claims bar date in this case was computed and noticed based on the rule and the code.

The Hudsons' pre-bar-date motion to value collateral and scheduling of MMCA cannot serve as an "informal proof of claim" authorizing the court to allow the creditor to file its claim post-bar-date. The Eleventh Circuit Court of Appeals outlined the requirements for a pleading to constitute an "informal proof of claim" in Charter Company v. Dioxin Claimants (In re Charter Company), 876 F.2d 861 (1989).

To qualify, a filing must generally be by or on behalf of the creditor, setting out the existence, nature, and amount of the claim, as well as evidencing the clear intent to hold the debtor liable on the claim. See Charter Company, 876 F.2d at 863. When the filing comprises these elements, it may fulfill the policy goals of the code and rules. Consequently, some courts have allowed late-filed

claims when these substantive requirements are met. See In re L. Meyer & Son Seafood Corp., 188 B.R. 315, 320 (Bankr. S.D. Fla. 1995).

Most courts have required action by or on behalf of the creditor as part of the informal proof of claim analysis. See Charter Company, 876 F.2d at 863 ("[A]ctions by a claimant **...** may constitute an informal proof of claim ..." (emphasis added)); and, see also In re Kinsak, 269 B.R. 49, 50 (Bankr. N.D. Cal. 2001) ("An informal proof of claim must be a writing ... filed by or on behalf of creditor." (emphasis added)); and In re U.S. Savings Assoc., LTD, 236 B.R. 289, 291 (Bankr. M.D. Fla. 1999) ("T]he doctrine only applies when the document to be treated as the informal proof of claim is filed by the creditor prior to the bar date." (emphasis added)).

Despite notice, MMCA took no action in this case by November 11, 2004. At the time of the May 10, 2005 hearing, MMCA had filed only two documents with the court – its 2005 notice of appearance and this motion to allow its late claim.

The Eleventh Circuit in Charter Company, 876 F.2d at 864, held that a creditor's motion for relief from stay to pursue a lawsuit against the debtor was sufficient because it clearly set forth the existence and nature of the debt, and the creditor's intention to hold the debtor liable. Additionally, the bankruptcy court in In re Boehm, 252 B.R. 576, 578 (Bankr. M.D. Fla. 2000) found that a pre-bar-date nondischargeability lawsuit against the debtor was an adequate informal proof of claim. See also In re Gonzalez, 259 B.R. 584, 589 (Bankr. N.D. Ill. 2003) (holding that an objection to confirmation, filed before the bar date, qualified since it showed the existence, nature and amount of the debt; and the creditor's intent to hold the debtor liable).

But compare Bowden v. Structured Investments Co. LLC (In re Bowden), 315 B.R. 903, 907 (Bankr. W.D. Wash. 2004) (holding that debtor's scheduling of the creditor was not sufficient

because no action was taken by the creditor); Kinsak, 269 B.R. at 50, (holding that pre-bar-date application for employment of debtor's counsel, and the debtor's disclosure statement, filed with the plan, were not sufficient because the actions were not taken by or on behalf of creditors); In re Boucek, 280 B.R. 533, 536 (Bankr. D. Kan. 2002) (holding that creditor's notice of appearance and request for service filed before the bar date did not qualify because they made no demand on debtor's estate or expressed intent to hold the debtor liable); and In re Edwards Theatres Circuit, Inc., 2003 WL 21751702 at *1 (9th Cir. 2003) (unpublished decision, cited as persuasive authority only) (creditor/leasor's letter sent the debtor was not adequate because it failed to show creditor's intent to hold debtor liable for rejected lease).

As with many issues on bankruptcy, a case-by-case analysis based on the facts is required. Even if the Hudsons' filings could be deemed as comprising all other elements of an "informal proof of claim," they do not evidence MMCA's intent to hold the debtors liable. (The nature, existence and amount of the debt were set out at the valuation hearing.) The facts tend to indicate just the opposite intent since the creditor failed to respond to or challenge the motion in any way. Subsequent to notice of the confirmed plan, MMCA also failed to file the proof of claim required to receive its $250.00 per month payment as a secured creditor.

For these reasons, the debtors' pre-bar-date unilateral filings cannot be deemed as an informal proof of claim filed by or on behalf of the creditor, authorizing the court to allow MMCA's tardily filed claim.

CONCLUSION

Consequently, the Bankruptcy Court had no choice but to **DENY** Mitsubishi Motor Credit of America's **MOTION TO ALLOW LATE CLAIM** (Doc. 41). That decision is

reflected by the court's order (Doc. 48), which was entered separately from these findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

DONE and ORDERED this June 10, 2005.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
WESTERN DIVISION

IN RE:

BK 03-73899-CMS-13

CHARLES HUBERT ANTHONY, and
DONNA KAYE MARLOWE ANTHONY,

DEBTORS.

AP 04-70007-CMS

C. DAVID COTTINGHAM,
as Chapter 13 Trustee

PLAINTIFFS

VS

ALABAMA CREDIT UNION,

DEFENDANT.

MEMORANDUM OF DECISION

This case is before the court in BK 03-73899 for confirmation on debtors' proposed plan of reorganization and Alabama Credit Union's objection. It is also before the court on AP 04-70007 which challenges Alabama Credit Union's liens on debtors' automobiles, requests the turnover of titles to the vehicles, and asserts that the credit union violated the automatic stay. For the reasons indicated below, the court **OVERRULES** Alabama Credit Union's objection to confirmation of the debtors' plan and an order of confirmation will be entered. The court further finds that the credit union's lien is due to be avoided pursuant to 11 U.S.C. Section 547 and that the credit union violated the automatic stay when it perfected its lien postpetition. The court **DENIES** the request for turnover of the titles.

FINDING OF FACTS

The debtors, Charles H. Anthony and Donna K. Anthony, are the owners of a 1994 Honda Accord, a 1994 Toyota Camry, and a 1995 Chevrolet C1500 truck. Prior to the filing

of their bankruptcy petition these automobiles served as collateral for a loan at Citizens Bank of Fayette (Citizens Bank). In August of 2003, Mr. Anthony went to Alabama Credit Union (credit union) to discuss refinancing of the loan with the credit union. It was Mr. Anthony's testimony that the credit union loan would save him approximately $100.00 per month in payments. Included in Plaintiff's Exhibit 1, marked as page 1-4, is a copy of a LOANLINER Open-End Disbursement Receipt Plus (Receipt Plus) form with a date of August 21, 2003, and pages 1-14 and 1-15 are copies of title applications on two of the subject automobiles dated August 21, 2003. From the testimony it appears that this is the date the Anthony's made their application for a loan with the credit union. According to the testimony of Donna Allison, branch manager and loan officer with the credit union, the loan was approved on September 5, 2003 and page 1-5 in Plaintiff's Exhibit 1 is a LOANLINER Open-End Plan Signatures PLUS (Signature Plus) form signed by the debtors and dated September 5, 2003. Also included in Plaintiff's Exhibit 1 at page 1-3 is a second Receipt Plus form dated September 30, 2003.

The first Receipt Plus form (Plaintiff's Exhibit 1, page 1-4) dated August 21, 2003 has the account number 39551 30 and pledges the three cars owned by the Anthonys as collateral with an annual percentage rate on the loan of 4.1%. The amount financed is $17,237.35, with a monthly payment of $509.74, with the first payment due September 21, 2003.

The second Receipt Plus form(Plaintiff's Exhibit 1, page 1-3) is dated September 30, 2003 and again pledges as collateral the Anthonys' three automobiles. The interest rate is 4.7% and the amount financed is $17,312.34, with a monthly payment of $511.92, with the first payment due October 30, 2003. The account number is 39551 31. Neither of these Receipt Plus documents are signed.

As noted earlier, pages 1-14 and 1-15 of Plaintiff's Exhibit 1 indicate that the title applications were dated August 21, 2003.

Mr. Anthony's testimony as to the chronology of events is as follows:

On approximately August 21, 2003 he first went to the credit union and talked about this loan. He returned to the credit union on September 8, 2003 and paid the credit union $16.50 for

each of the three automobile title applications which were being submitted on behalf of the credit union. These payments for the title applications were on September 8, 2003, not August 21, 2003. The next payment was due at Citizens Bank on September 15, 2003 and it was his understanding that the credit union would pay off this account prior to that date. Defendant's Exhibit 1 is a copy of an authorization signed by Mr. and Mrs. Anthony and the credit union authorizing Citizens Bank to accept $17,237.35 to pay off the three subject automobiles and is captioned "NOTICE FOR AUTHORIZATION FOR PAYOFF AND DEMAND FOR TITLE". The date appears to be September 19, 2003. Plaintiff's Exhibit 3 is a copy of a notice dated September 26, 2003 from Citizens Bank to Mr. Anthony advising him that his loan payment is due, and written on the notice is the number 17,312.34 until 2:30 tomorrow. That is the same amount indicated on Plaintiff's Exhibit 1 at page 1-3 for the amount of funds being advanced on September 30, 2003. This is greater than the amount shown on Defendant's Exhibit 1 which showed the amount to be paid as $17,237.35, the same amount indicated on Plaintiff's Exhibit 1 at page 1-4 on the August 21, 2003 Receipt Plus agreement. What appears to have happened is the credit union failed to disburse the funds to Citizens Bank before the September 2003 payment was due; and therefore, additional interest and a late charge were added to the amount required to pay off the Citizens Bank balance.

After receiving the late notice from the Citizens Bank, Mr. Anthony went to the credit union to find out what had happened. The credit union then gave him a check and a piece of paper to take to Citizens Bank to pay off the Citizens Bank loan. He testified that he took Defendant's Exhibit 1, along with the check to Citizens Bank. Citizens Bank gave him his note marked paid and the three titles to his automobiles with the liens released. He took them home, rather than returning them to the credit union. He made payments to the credit union in October and December and received no inquiry from the credit union concerning the titles. On December 9, 2003, he did receive a telephone call from the credit union about the location of the titles. When he advised them that he had them, they asked him to return the titles to them, and he did so that same day. The next day, December 10, 2003, he had an appointment with his

attorney. The Anthonys' bankruptcy petition was filed December 12, 2003.

January 5, 2004, the credit union mailed the title applications to the State of Alabama, and Plaintiff's Exhibit 1 at page 1-14 indicates that at least two of the applications were received January 15, 2004.

In summary, the evidence shows that on October 1, 2003 Alabama Credit Union advanced funds on behalf of the Anthonys which paid their loan at Citizens Bank, which was secured by the Anthonys' three automobiles. Sometime prior to October 1, 2003, either August 21, 2003, September 5, 2003, September 8, 2003, or September 30, 2003, the Anthonys granted the credit union a security interest in these three automobiles. On December 12, 2003, when the bankruptcy petition was filed, the credit union had in its possession the three titles, but had not submitted these titles to the Alabama Department of Revenue in order to perfect their lien on the automobiles.

The debtors filed their plan, along with their schedules, December 12, 2003. Under their plan, the debtors treated the credit union as an unsecured creditor and proposed to pay all unsecured creditors, including the credit union, the liquidation value of the three automobiles.

January 22, 2004, the credit union filed its claim asserting that it was a secured creditor in the amount of $16,499.82. (Proof of Claim #3) The credit union asserted that it held a lien on the debtors' three automobiles.

February 2, 2004, the debtors objected to the credit union's claim (Doc. 5) and alleged that the credit union was either an unsecured creditor on the date of filing or the holder of an avoidable lien. February 5, 2004 the debtors also filed AP 04-70007. Count One of the complaint alleged that the perfection of the credit union's lien was a preferential transfer under 11 U.S.C. Section 547. Count Two requested an order that the credit union turn over to the debtor titles to the automobiles with all claimed liens noted as released. Paragraph Three alleged that the credit union perfected its lien after the debtors filed their petition; and therefore, violated the automatic stay under 11 U.S.C. Section 362.

February 3, 2004, the credit union objected to confirmation (BK Doc. 8).

April 14, 2004 debtors moved for summary judgment (AP Doc. 8); and, on June 16, 2004, the credit union filed its MOTION FOR SUMMARY JUDGMENT (AP Doc. 17).

August 5, 2004, the debtors filed a MOTION TO SUBSTITUTE C. DAVID COTTINGHAM, CHAPTER 13 TRUSTEE AS PLAINTIFF (AP Doc. 26) which was granted September 9, 2004 (AP Doc. 31). The debtors' motion for summary judgment was denied August 26, 2004 (AP Doc. 29). The credit union's motion for summary judgment was denied February 24, 2005 and the matter was set for trial March 3, 2005.

CONCLUSIONS OF LAW

This court has jurisdiction of Charles H. Anthony's and Donna K. Anthony's Chapter 13 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this adversary proceeding, a core bankruptcy proceeding as listed at 28 U.S.C. §§ 157(b)(2)(E), (F), and (K), pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court, pursuant to 28 U.S.C. § 157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, As Amended July 17,1984.

The relief the trustee seeks in his lawsuit, the debtors' objection the classification of the credit union's claim, and the credit union's objection to confirmation of the Anthonys' Chapter 13 plan arise from the same facts and are governed by the same set of legal conclusions. Consequently, the court will deem all issues subsumed into the discussion in this Memorandum of Decision. The memorandum and its accompanying orders will address all issues, with orders consistent with these findings entered in both BK 03-73899-CMS-13 and AP 04-70007.

The issues raised in this case are as follows:

1. Should the credit union's lien be avoided pursuant to 11 U.S.C. § 547?

2. Should the credit union be required to turn over the titles to the debtors' vehicles, and release its liens?

3. Did the credit union violate the automatic stay when it perfected its lien postpetition?

4. Should the debtors' plan be confirmed over the objection of the credit union?

5. Should the debtors' objection to the secured classification of the credit union's claim be sustained?

I.

The trustee may avoid Alabama Credit Union's lien in the Anthonys' vehicles.

Count One of the complaint in this adversary proceeding, originally filed by the debtors and now prosecuted by the trustee, does not state that it is brought as a preference action pursuant to 11 U.S.C. §547. However, it recites all of the elements required by Section 547(b) as the basis for such avoidance.

The facts show that on the date the Anthonys filed bankruptcy, the credit union had in its possession titles to all three automobiles, but had not applied to the State Department of Revenue for new titles showing the credit union as first lienholder. Usually in such circumstances, a trustee would sue the creditor under 11 U.S.C. § 544(a), since his interest as a hypothetical judgment lienor as of the December 12, 2003 petition date, would take priority over the credit union's unperfected security interest. In this case, the trustee was required to specifically prove five factual elements to be successful in a Section 547(b) challenge.

Section 547(b) provides as follows:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made –
> (A) on or within 90 days before the date of the filing of the petition; or
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
> (5) that enables such creditor to receive more than such creditor would receive if –
> (A) the case were a case under Chapter 7 of this title;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The transfer at issue is the Anthonys' grant of a security interest to the credit union and the creditor's subsequent failure to timely perfect that interest in its collateral. For it is undisputed that the facts show the credit union had not fulfilled the legal requirements for perfection until more than a month after bankruptcy.

Section 547(e) defines when a "transfer" takes place in the meaning of 547(b). When such

a transfer has not been perfected on the petition date, Section 547(e)(2)(C) provides that the transfer is deemed made "immediately before the date of the filing of the petition, if such transfer is not perfected at the later of – (i) the commencement of the case; or (ii) 10 days after such transfer takes effect between the transferor and the transferee." Since the credit union's security interest was not perfected until more than 10 days after the bankruptcy itself, under Section 547(e), it is deemed to have occurred on the petition date, December 12, 2003.

As for the elements needed to prove a Section 547 preference, the court has analyzed these facts in the following way:

As required by Section 547(b)(1), the Anthonys' grant of a security interest to the creditor as collateral for its loan is clearly a transfer "to or for the benefit of a creditor." Under Section 547(b)(2), the debtors' grant of the security interest was also "on account of an antecedent debt." Although the parties offered different dates for the credit union's payment of the Anthony's debt, the latest was October 1, 2003. That date and the debt it created is "antecedent" to December 12, 2003, when Section 547(e) sets the unperfected transfer of the security interest.

Pursuant to Section 547(b)(3), the Anthonys must also have been insolvent at the time of the challenged transfer. Section 547(f) creates the presumption that debtors are insolvent for the 90 days before they file bankruptcy, and no evidence in this case contradicts that presumption. Therefore, the Anthonys were insolvent in the meaning of the Section 547(b).

Section 547(b)(4) requires that the transfer have taken place "on or within 90 days" before bankruptcy was filed. Since the transfer is deemed to have occurred "immediately before" the filing of the petition on December 12, 2003, it is within the required 90 days.

Section 547(b)(5) requires that a preference must be a transfer allowing the creditor to receive more in a Chapter 7 liquidation than it would have if the transfer were avoided.

In the Chapter 7 liquidation context, if the credit union held an unperfected lien as of the petition date, its collateral would be sold by the trustee and the proceeds distributed pro-rata to all the Anthonys' unsecured creditors. Those unsecured creditors would include the credit union if the transfer is avoided. Since the vehicles comprise the only non-exempt assets of the Anthony

bankruptcy estate, the credit union would get only a pro-rata share of the sale proceeds, along with other unsecured creditors. If the transfer is not avoided, the credit union would get 100 percent of the sale proceeds, and the other creditors would get nothing. Consequently, if the transfer stands, it would allow the credit union to receive more than it would have received in a Chapter 7 liquidation.

Consequently, the record facts show that the Anthony/Alabama Credit Union transaction met all the elements required for avoidance under Section 547(b).

The credit union asserted the equitable doctrine of earmarking as a defense in this case. "Earmarking" is a judicially created exception to Section 547(b) avoidance. Collier on Bankruptcy, Alan N. Resnick and Henry J. Sommer, 15th Ed., described earmarking in the following way at Paragraph 547.03[2]:

> Under the "earmarking doctrine," funds provided to a debtor for the purpose of paying a specific indebtedness may not be recoverable as a preference from the creditor to which they are paid, on the premise that the property "transferred" in such a situation was never property of the debtor and so the transfer did not disadvantage other creditors.

A bankruptcy court discussed earmarking in Vieira v. Anna National Bank (In re Messamore), 250 B.R. 913, (Bankr. S.D. Ill. 2000). Messamore involved a refinancing transaction almost identical to the case at hand. The court stated:

> The earmarking doctrine, as developed in case law, is clearly applicable in a refinancing situation to determine whether the debtor's payment of an existing creditor with funds borrowed from a new creditor constitutes a preferential transfer–that is, whether such payment is a transfer of the debtor's "interest in property" to pay the debt owed to the first creditor. This case, however, presents an entirely different question. Here, it is not the transfer of the funds to the debtors' original creditor, Green Point, that is at issue, but the transfer that occurred when the new creditor, Anna Bank, perfected its lien on the debtors' mobile home more than 10 days after execution of the parties' loan agreement. Under the definition of "transfer" applicable in preference actions, the debtors' transfer of an interest in their mobile home did not occur at the time of the loan transaction when they incurred their obligation to Anna Bank. Rather, because Anna Bank failed to perfect within 10 days after the parties' transaction, transfer of the debtors' interest is deemed to have occurred at the time Anna Bank perfected its loan over two months later. See 11 U.S.C. § 547(e)(2)(B). It is this latter transfer, the transfer of the debtors' interest in the mobile home to Anna Bank to secure their pre-existent obligation, that the trustee alleges is preferential. Although the debtors' transfer to Anna Bank arose in the context of a refinancing arrangement, it did not involve payment of funds by a third party or, indeed, the payment of borrowed funds at all. For this reason, the earmarking doctrine has no logical relevance to such transfer. The transfer to Anna Bank that occurred upon perfection of its lien was separate and distinct from the transfer that occurred when Green Point was paid with the borrowed funds, and this transfer was clearly a transfer of the debtors' interest in property, as it depended on the debtors' grant of a security interest to Anna Bank. The earmarking doctrine, therefore is inapplicable in the present case to shield the debtors' transfer to Anna Bank from avoidance

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See Messamore, 250 B.R. at 917.

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> Judge Meyers pointed out that, while the earmarking doctrine may apply to payments of funds from a subsequent creditor to the original creditor, it has no application with respect to the subsequent creditor's obligation to timely record its lien, which is a separate and distinct transfer.

See Moeri, 300 B.R. at 329.

The transfer at issue in the Anthony case, like the transfers in Messamore and Moeri, is the perfection of the credit union's own lien on the debtor's automobiles, not the credit union's payment/transfer to Citizens Bank for release of that bank's prior lien. Therefore, the court finds the credit union's lien constitutes an avoidable preference under Section 547(b) and is preserved for the benefit of the bankruptcy estate pursuant to 11 U.S.C. § 551. Section 551 provides the following:

> **Automatic preservation of avoided transfer.**
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> Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate. (emphasis added)

The trustee (as creditors' representative) has been substituted as plaintiff in place of the Anthonys. Consequently, the debtors' original request for turnover of the titles under Section 542, and release of the liens is due to be denied at this point.

Further, 11 U.S.C. § 349 provides for reinstatement of the avoided liens if the Anthonys do not complete payments under their plan. Section 349(b)(1)(B) states:

> **Effect of dismissal.**
> (b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under section 742 of this title–
> (1) reinstates–
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So it is premature to grant the request for turnover or release of the liens at this point in the case.

Additionally, the complaint is correct in its allegation that the credit union's action to perfect its lien postpetition is a technical violation of the automatic stay pursuant to 11 U.S.C. § 362(a)(4)[1]. However, there is no evidence that the estate or the debtors suffered damage as a result pursuant to 11 U.S.C. § 362(h)[2]. As a result, the credit union has no liability for the technical violation.

Consequently, judgment is to be entered in favor of the Chapter 13 trustee, and against the creditor on the Section 547(b) avoidance claim.

II.

The Anthonys' Chapter 13 plan is due to be confirmed; the credit union's objection is to be overruled; and the debtors' objection to the creditors' secured classification, sustained.

While the debtors' transfer of their interest in the cars is to be avoided, Section 551 preserves the interest for the benefit of the estate, not of the individual debtors. 11 U.S.C. § 1325 sets out the requirements a Chapter 13 plan must satisfy to be confirmed.

11 U.S.C. § 1325(a)(4) is commonly referred to "the best interest of creditors test" meaning that the plan must provide that:

(a) Except as provided in subsection (b), the court shall confirm a plan if– ...

> (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date; ...

At the least, the Anthonys must pay unsecured creditors the value of the three autos as of the

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[1] **Section 362(a)(4)** provides the following:

Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of– ...

> (4) any act to create, perfect, or enforce any lien against property of the estate; ...

[2] **Section 362(h)** provides the following:

An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

effective date of the plan. The parties have stipulated that the autos had a value of $16,550.00 as of the date of filing. The Anthonys' plan proposed to pay unsecured creditors $18,596.00. That distribution would represent the present value of the autos, with interest, paid to creditors over the life of the plan as required by Section 1325(a)(4).

The credit union's objection to confirmation of the plan protested the Anthonys' treatment of the creditor's claim as unsecured, rather than secured. The facts in McRoberts v. TranSouth Financial (In re Bell), 194 B.R. 192 (Bankr. S.D. Ill. 1996) were virtually identical to the Anthony case. The trustee in Bell avoided a creditor's liens in automobiles because it had failed to perfect its security interest prior to the bankruptcy filing. The court found that the unperfected lien creditor would be an unsecured creditor under terms of the Chapter 13 plan; that unsecured creditors would receive the liquidation value of the vehicles pursuant to Section 1325(a)(4); and that, upon successful completion of payments under the plan terms, the debtor would own the automobiles free and clear of the creditor's lien.

The Anthonys' plan, as proposed, is therefore due to be confirmed, and the credit union's objection to confirmation overruled.

The credit union had filed Proof of Claim 3 for $16,499.82 as a secured claim. The Anthonys had objected to the classification of Claim 3 as secured, asserting it should be allowed as unsecured. The debtors did not dispute the amount of the claim. The creditor's lien has been avoided by the trustee. As stated in Bell, 194 B.R. at 197:

> [T]he trustee's avoidance of the creditors' liens results in nullification of the transfer of property represented by those liens, and the security transactions are ineffective not only as to the trustee but also as to the debtor and creditor themselves as the immediate parties to the transactions.

Therefore, the debtors objection to the secured status of the claim is due to be sustained, and the credit union's Claim 3 is allowed as unsecured in the amount of $16,499.82. As noted in Bell, while the liens have been avoided in this bankruptcy case, they are subject to reinstatement if the case is dismissed prior to the Anthonys' Chapter 13 discharge.

CONCLUSION

In summary, the court finds judgment in AP 04-70007 must be entered **IN FAVOR OF THE**

TRUSTEE, and **AGAINST THE ALABAMA CREDIT UNION** on the Section 547(b) avoidance of the credit union's lien. Further, in BK 03-73899, the court finds that the Anthonys's Chapter 13 plan, as proposed, is **DUE TO BE CONFIRMED**; the creditor's objection to confirmation **OVERRULED;** and the debtors' objection to the secured status of the claim, **SUSTAINED**.

Orders, consistent with these findings pursuant to Fed. R. Bankr. R. 7052, will be entered separately.

DONE and ORDERED this June 28, 2005.

/s/ C. Michael Stilson

C. Michael Stilson

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
WESTERN DIVISION

IN RE:

BK 03-73899-CMS-13

CHARLES HUBERT ANTHONY, and
DONNA KAYE MARLOWE ANTHONY,

DEBTORS.

AP 04-70007-CMS

C. DAVID COTTINGHAM,
as Chapter 13 Trustee

PLAINTIFFS

VS

ALABAMA CREDIT UNION,

DEFENDANT.

MEMORANDUM OF DECISION

This case is before the court in BK 03-73899 for confirmation on debtors' proposed plan of reorganization and Alabama Credit Union's objection. It is also before the court on AP 04-70007 which challenges Alabama Credit Union's liens on debtors' automobiles, requests the turnover of titles to the vehicles, and asserts that the credit union violated the automatic stay. For the reasons indicated below, the court **OVERRULES** Alabama Credit Union's objection to confirmation of the debtors' plan and an order of confirmation will be entered. The court further finds that the credit union's lien is due to be avoided pursuant to 11 U.S.C. Section 547 and that the credit union violated the automatic stay when it perfected its lien postpetition. The court **DENIES** the request for turnover of the titles.

FINDING OF FACTS

The debtors, Charles H. Anthony and Donna K. Anthony, are the owners of a 1994 Honda Accord, a 1994 Toyota Camry, and a 1995 Chevrolet C1500 truck. Prior to the filing

of their bankruptcy petition these automobiles served as collateral for a loan at Citizens Bank of Fayette (Citizens Bank). In August of 2003, Mr. Anthony went to Alabama Credit Union (credit union) to discuss refinancing of the loan with the credit union. It was Mr. Anthony's testimony that the credit union loan would save him approximately $100.00 per month in payments. Included in Plaintiff's Exhibit 1, marked as page 1-4, is a copy of a LOANLINER Open-End Disbursement Receipt Plus (Receipt Plus) form with a date of August 21, 2003, and pages 1-14 and 1-15 are copies of title applications on two of the subject automobiles dated August 21, 2003. From the testimony it appears that this is the date the Anthony's made their application for a loan with the credit union. According to the testimony of Donna Allison, branch manager and loan officer with the credit union, the loan was approved on September 5, 2003 and page 1-5 in Plaintiff's Exhibit 1 is a LOANLINER Open-End Plan Signatures PLUS (Signature Plus) form signed by the debtors and dated September 5, 2003. Also included in Plaintiff's Exhibit 1 at page 1-3 is a second Receipt Plus form dated September 30, 2003.

The first Receipt Plus form (Plaintiff's Exhibit 1, page 1-4) dated August 21, 2003 has the account number 39551 30 and pledges the three cars owned by the Anthonys as collateral with an annual percentage rate on the loan of 4.1%. The amount financed is $17,237.35, with a monthly payment of $509.74, with the first payment due September 21, 2003.

The second Receipt Plus form(Plaintiff's Exhibit 1, page 1-3) is dated September 30, 2003 and again pledges as collateral the Anthonys' three automobiles. The interest rate is 4.7% and the amount financed is $17,312.34, with a monthly payment of $511.92, with the first payment due October 30, 2003. The account number is 39551 31. Neither of these Receipt Plus documents are signed.

As noted earlier, pages 1-14 and 1-15 of Plaintiff's Exhibit 1 indicate that the title applications were dated August 21, 2003.

Mr. Anthony's testimony as to the chronology of events is as follows:

On approximately August 21, 2003 he first went to the credit union and talked about this loan. He returned to the credit union on September 8, 2003 and paid the credit union $16.50 for

each of the three automobile title applications which were being submitted on behalf of the credit union. These payments for the title applications were on September 8, 2003, not August 21, 2003. The next payment was due at Citizens Bank on September 15, 2003 and it was his understanding that the credit union would pay off this account prior to that date. Defendant's Exhibit 1 is a copy of an authorization signed by Mr. and Mrs. Anthony and the credit union authorizing Citizens Bank to accept $17,237.35 to pay off the three subject automobiles and is captioned "NOTICE FOR AUTHORIZATION FOR PAYOFF AND DEMAND FOR TITLE". The date appears to be September 19, 2003. Plaintiff's Exhibit 3 is a copy of a notice dated September 26, 2003 from Citizens Bank to Mr. Anthony advising him that his loan payment is due, and written on the notice is the number 17,312.34 until 2:30 tomorrow. That is the same amount indicated on Plaintiff's Exhibit 1 at page 1-3 for the amount of funds being advanced on September 30, 2003. This is greater than the amount shown on Defendant's Exhibit 1 which showed the amount to be paid as $17,237.35, the same amount indicated on Plaintiff's Exhibit 1 at page 1-4 on the August 21, 2003 Receipt Plus agreement. What appears to have happened is the credit union failed to disburse the funds to Citizens Bank before the September 2003 payment was due; and therefore, additional interest and a late charge were added to the amount required to pay off the Citizens Bank balance.

After receiving the late notice from the Citizens Bank, Mr. Anthony went to the credit union to find out what had happened. The credit union then gave him a check and a piece of paper to take to Citizens Bank to pay off the Citizens Bank loan. He testified that he took Defendant's Exhibit 1, along with the check to Citizens Bank. Citizens Bank gave him his note marked paid and the three titles to his automobiles with the liens released. He took them home, rather than returning them to the credit union. He made payments to the credit union in October and December and received no inquiry from the credit union concerning the titles. On December 9, 2003, he did receive a telephone call from the credit union about the location of the titles. When he advised them that he had them, they asked him to return the titles to them, and he did so that same day. The next day, December 10, 2003, he had an appointment with his

attorney. The Anthonys' bankruptcy petition was filed December 12, 2003.

January 5, 2004, the credit union mailed the title applications to the State of Alabama, and Plaintiff's Exhibit 1 at page 1-14 indicates that at least two of the applications were received January 15, 2004.

In summary, the evidence shows that on October 1, 2003 Alabama Credit Union advanced funds on behalf of the Anthonys which paid their loan at Citizens Bank, which was secured by the Anthonys' three automobiles. Sometime prior to October 1, 2003, either August 21, 2003, September 5, 2003, September 8, 2003, or September 30, 2003, the Anthonys granted the credit union a security interest in these three automobiles. On December 12, 2003, when the bankruptcy petition was filed, the credit union had in its possession the three titles, but had not submitted these titles to the Alabama Department of Revenue in order to perfect their lien on the automobiles.

The debtors filed their plan, along with their schedules, December 12, 2003. Under their plan, the debtors treated the credit union as an unsecured creditor and proposed to pay all unsecured creditors, including the credit union, the liquidation value of the three automobiles.

January 22, 2004, the credit union filed its claim asserting that it was a secured creditor in the amount of $16,499.82. (Proof of Claim #3) The credit union asserted that it held a lien on the debtors' three automobiles.

February 2, 2004, the debtors objected to the credit union's claim (Doc. 5) and alleged that the credit union was either an unsecured creditor on the date of filing or the holder of an avoidable lien. February 5, 2004 the debtors also filed AP 04-70007. Count One of the complaint alleged that the perfection of the credit union's lien was a preferential transfer under 11 U.S.C. Section 547. Count Two requested an order that the credit union turn over to the debtor titles to the automobiles with all claimed liens noted as released. Paragraph Three alleged that the credit union perfected its lien after the debtors filed their petition; and therefore, violated the automatic stay under 11 U.S.C. Section 362.

February 3, 2004, the credit union objected to confirmation (BK Doc. 8).

April 14, 2004 debtors moved for summary judgment (AP Doc. 8); and, on June 16, 2004, the credit union filed its MOTION FOR SUMMARY JUDGMENT (AP Doc. 17).

August 5, 2004, the debtors filed a MOTION TO SUBSTITUTE C. DAVID COTTINGHAM, CHAPTER 13 TRUSTEE AS PLAINTIFF (AP Doc. 26) which was granted September 9, 2004 (AP Doc. 31). The debtors' motion for summary judgment was denied August 26, 2004 (AP Doc. 29). The credit union's motion for summary judgment was denied February 24, 2005 and the matter was set for trial March 3, 2005.

CONCLUSIONS OF LAW

This court has jurisdiction of Charles H. Anthony's and Donna K. Anthony's Chapter 13 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this adversary proceeding, a core bankruptcy proceeding as listed at 28 U.S.C. §§ 157(b)(2)(E), (F), and (K), pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court, pursuant to 28 U.S.C. § 157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, As Amended July 17,1984.

The relief the trustee seeks in his lawsuit, the debtors' objection the classification of the credit union's claim, and the credit union's objection to confirmation of the Anthonys' Chapter 13 plan arise from the same facts and are governed by the same set of legal conclusions. Consequently, the court will deem all issues subsumed into the discussion in this Memorandum of Decision. The memorandum and its accompanying orders will address all issues, with orders consistent with these findings entered in both BK 03-73899-CMS-13 and AP 04-70007.

The issues raised in this case are as follows:

1. Should the credit union's lien be avoided pursuant to 11 U.S.C. § 547?

2. Should the credit union be required to turn over the titles to the debtors' vehicles, and release its liens?

3. Did the credit union violate the automatic stay when it perfected its lien postpetition?

4. Should the debtors' plan be confirmed over the objection of the credit union?

5. Should the debtors' objection to the secured classification of the credit union's claim be sustained?

I.

The trustee may avoid Alabama Credit Union's lien in the Anthonys' vehicles.

Count One of the complaint in this adversary proceeding, originally filed by the debtors and now prosecuted by the trustee, does not state that it is brought as a preference action pursuant to 11 U.S.C. §547. However, it recites all of the elements required by Section 547(b) as the basis for such avoidance.

The facts show that on the date the Anthonys filed bankruptcy, the credit union had in its possession titles to all three automobiles, but had not applied to the State Department of Revenue for new titles showing the credit union as first lienholder. Usually in such circumstances, a trustee would sue the creditor under 11 U.S.C. § 544(a), since his interest as a hypothetical judgment lienor as of the December 12, 2003 petition date, would take priority over the credit union's unperfected security interest. In this case, the trustee was required to specifically prove five factual elements to be successful in a Section 547(b) challenge.

Section 547(b) provides as follows:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made –
> (A) on or within 90 days before the date of the filing of the petition; or
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
> (5) that enables such creditor to receive more than such creditor would receive if –
> (A) the case were a case under Chapter 7 of this title;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The transfer at issue is the Anthonys' grant of a security interest to the credit union and the creditor's subsequent failure to timely perfect that interest in its collateral. For it is undisputed that the facts show the credit union had not fulfilled the legal requirements for perfection until more than a month after bankruptcy.

Section 547(e) defines when a "transfer" takes place in the meaning of 547(b). When such

a transfer has not been perfected on the petition date, Section 547(e)(2)(C) provides that the transfer is deemed made "immediately before the date of the filing of the petition, if such transfer is not perfected at the later of – (i) the commencement of the case; or (ii) 10 days after such transfer takes effect between the transferor and the transferee." Since the credit union's security interest was not perfected until more than 10 days after the bankruptcy itself, under Section 547(e), it is deemed to have occurred on the petition date, December 12, 2003.

As for the elements needed to prove a Section 547 preference, the court has analyzed these facts in the following way:

As required by Section 547(b)(1), the Anthonys' grant of a security interest to the creditor as collateral for its loan is clearly a transfer "to or for the benefit of a creditor." Under Section 547(b)(2), the debtors' grant of the security interest was also "on account of an antecedent debt." Although the parties offered different dates for the credit union's payment of the Anthony's debt, the latest was October 1, 2003. That date and the debt it created is "antecedent" to December 12, 2003, when Section 547(e) sets the unperfected transfer of the security interest.

Pursuant to Section 547(b)(3), the Anthonys must also have been insolvent at the time of the challenged transfer. Section 547(f) creates the presumption that debtors are insolvent for the 90 days before they file bankruptcy, and no evidence in this case contradicts that presumption. Therefore, the Anthonys were insolvent in the meaning of the Section 547(b).

Section 547(b)(4) requires that the transfer have taken place "on or within 90 days" before bankruptcy was filed. Since the transfer is deemed to have occurred "immediately before" the filing of the petition on December 12, 2003, it is within the required 90 days.

Section 547(b)(5) requires that a preference must be a transfer allowing the creditor to receive more in a Chapter 7 liquidation than it would have if the transfer were avoided.

In the Chapter 7 liquidation context, if the credit union held an unperfected lien as of the petition date, its collateral would be sold by the trustee and the proceeds distributed pro-rata to all the Anthonys' unsecured creditors. Those unsecured creditors would include the credit union if the transfer is avoided. Since the vehicles comprise the only non-exempt assets of the Anthony

bankruptcy estate, the credit union would get only a pro-rata share of the sale proceeds, along with other unsecured creditors. If the transfer is not avoided, the credit union would get 100 percent of the sale proceeds, and the other creditors would get nothing. Consequently, if the transfer stands, it would allow the credit union to receive more than it would have received in a Chapter 7 liquidation.

Consequently, the record facts show that the Anthony/Alabama Credit Union transaction met all the elements required for avoidance under Section 547(b).

The credit union asserted the equitable doctrine of earmarking as a defense in this case. "Earmarking" is a judicially created exception to Section 547(b) avoidance. Collier on Bankruptcy, Alan N. Resnick and Henry J. Sommer, 15th Ed., described earmarking in the following way at Paragraph 547.03[2]:

> Under the "earmarking doctrine," funds provided to a debtor for the purpose of paying a specific indebtedness may not be recoverable as a preference from the creditor to which they are paid, on the premise that the property "transferred" in such a situation was never property of the debtor and so the transfer did not disadvantage other creditors.

A bankruptcy court discussed earmarking in Vieira v. Anna National Bank (In re Messamore), 250 B.R. 913, (Bankr. S.D. Ill. 2000). Messamore involved a refinancing transaction almost identical to the case at hand. The court stated:

> The earmarking doctrine, as developed in case law, is clearly applicable in a refinancing situation to determine whether the debtor's payment of an existing creditor with funds borrowed from a new creditor constitutes a preferential transfer–that is, whether such payment is a transfer of the debtor's "interest in property" to pay the debt owed to the first creditor. This case, however, presents an entirely different question. Here, it is not the transfer of the funds to the debtors' original creditor, Green Point, that is at issue, but the transfer that occurred when the new creditor, Anna Bank, perfected its lien on the debtors' mobile home more than 10 days after execution of the parties' loan agreement. Under the definition of "transfer" applicable in preference actions, the debtors' transfer of an interest in their mobile home did not occur at the time of the loan transaction when they incurred their obligation to Anna Bank. Rather, because Anna Bank failed to perfect within 10 days after the parties' transaction, transfer of the debtors' interest is deemed to have occurred at the time Anna Bank perfected its loan over two months later. See 11 U.S.C. § 547(e)(2)(B). It is this latter transfer, the transfer of the debtors' interest in the mobile home to Anna Bank to secure their pre-existent obligation, that the trustee alleges is preferential. Although the debtors' transfer to Anna Bank arose in the context of a refinancing arrangement, it did not involve payment of funds by a third party or, indeed, the payment of borrowed funds at all. For this reason, the earmarking doctrine has no logical relevance to such transfer. The transfer to Anna Bank that occurred upon perfection of its lien was separate and distinct from the transfer that occurred when Green Point was paid with the borrowed funds, and this transfer was clearly a transfer of the debtors' interest in property, as it depended on the debtors' grant of a security interest to Anna Bank. The earmarking doctrine, therefore is inapplicable in the present case to shield the debtors' transfer to Anna Bank from avoidance

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See Moeri, 300 B.R. at 329.

The transfer at issue in the Anthony case, like the transfers in Messamore and Moeri, is the perfection of the credit union's own lien on the debtor's automobiles, not the credit union's payment/transfer to Citizens Bank for release of that bank's prior lien. Therefore, the court finds the credit union's lien constitutes an avoidable preference under Section 547(b) and is preserved for the benefit of the bankruptcy estate pursuant to 11 U.S.C. § 551. Section 551 provides the following:

> **Automatic preservation of avoided transfer.**
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> Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate. (emphasis added)

The trustee (as creditors' representative) has been substituted as plaintiff in place of the Anthonys. Consequently, the debtors' original request for turnover of the titles under Section 542, and release of the liens is due to be denied at this point.

Further, 11 U.S.C. § 349 provides for reinstatement of the avoided liens if the Anthonys do not complete payments under their plan. Section 349(b)(1)(B) states:

> **Effect of dismissal.**
> (b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under section 742 of this title–
> (1) reinstates–
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So it is premature to grant the request for turnover or release of the liens at this point in the case.

Additionally, the complaint is correct in its allegation that the credit union's action to perfect its lien postpetition is a technical violation of the automatic stay pursuant to 11 U.S.C. § 362(a)(4)[1]. However, there is no evidence that the estate or the debtors suffered damage as a result pursuant to 11 U.S.C. § 362(h)[2]. As a result, the credit union has no liability for the technical violation.

Consequently, judgment is to be entered in favor of the Chapter 13 trustee, and against the creditor on the Section 547(b) avoidance claim.

II.

The Anthonys' Chapter 13 plan is due to be confirmed; the credit union's objection is to be overruled; and the debtors' objection to the creditors' secured classification, sustained.

While the debtors' transfer of their interest in the cars is to be avoided, Section 551 preserves the interest for the benefit of the estate, not of the individual debtors. 11 U.S.C. § 1325 sets out the requirements a Chapter 13 plan must satisfy to be confirmed.

11 U.S.C. § 1325(a)(4) is commonly referred to "the best interest of creditors test" meaning that the plan must provide that:

(a) Except as provided in subsection (b), the court shall confirm a plan if– ...

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At the least, the Anthonys must pay unsecured creditors the value of the three autos as of the

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(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of– ...

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The credit union's objection to confirmation of the plan protested the Anthonys' treatment of the creditor's claim as unsecured, rather than secured. The facts in McRoberts v. TranSouth Financial (In re Bell), 194 B.R. 192 (Bankr. S.D. Ill. 1996) were virtually identical to the Anthony case. The trustee in Bell avoided a creditor's liens in automobiles because it had failed to perfect its security interest prior to the bankruptcy filing. The court found that the unperfected lien creditor would be an unsecured creditor under terms of the Chapter 13 plan; that unsecured creditors would receive the liquidation value of the vehicles pursuant to Section 1325(a)(4); and that, upon successful completion of payments under the plan terms, the debtor would own the automobiles free and clear of the creditor's lien.

The Anthonys' plan, as proposed, is therefore due to be confirmed, and the credit union's objection to confirmation overruled.

The credit union had filed Proof of Claim 3 for $16,499.82 as a secured claim. The Anthonys had objected to the classification of Claim 3 as secured, asserting it should be allowed as unsecured. The debtors did not dispute the amount of the claim. The creditor's lien has been avoided by the trustee. As stated in Bell, 194 B.R. at 197:

> [T]he trustee's avoidance of the creditors' liens results in nullification of the transfer of property represented by those liens, and the security transactions are ineffective not only as to the trustee but also as to the debtor and creditor themselves as the immediate parties to the transactions.

Therefore, the debtors objection to the secured status of the claim is due to be sustained, and the credit union's Claim 3 is allowed as unsecured in the amount of $16,499.82. As noted in Bell, while the liens have been avoided in this bankruptcy case, they are subject to reinstatement if the case is dismissed prior to the Anthonys' Chapter 13 discharge.

CONCLUSION

In summary, the court finds judgment in AP 04-70007 must be entered **IN FAVOR OF THE**

TRUSTEE, and **AGAINST THE ALABAMA CREDIT UNION** on the Section 547(b) avoidance of the credit union's lien. Further, in BK 03-73899, the court finds that the Anthonys's Chapter 13 plan, as proposed, is **DUE TO BE CONFIRMED**; the creditor's objection to confirmation **OVERRULED;** and the debtors' objection to the secured status of the claim, **SUSTAINED**.

Orders, consistent with these findings pursuant to Fed. R. Bankr. R. 7052, will be entered separately.

DONE and ORDERED this June 28, 2005.

/s/ C. Michael Stilson

C. Michael Stilson

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

TERRY JEROME HANKS and
SANDRANETTA HANKS, **BK 97-72646-CMS-13**

DEBTORS.

TERRY HANKS,
SANDRANETTA HANKS, **AP 04-70072-CMS**

PLAINTIFF,

vs.

SELECT PORTFOLIO SERVICING, INC.,

DEFENDANT.

MEMORANDUM OF DECISION

This matter is before the court on Terry Jerome and Sandranetta Hankses' suit to hold Select Portfolio Servicing, Inc.(SPS) in contempt of the court's July 9, 2002 discharge order after their completion of a Chapter 13 plan, (BK 97-72646-CMS-13). The court has reviewed the records of the cases, Sandranetta Hanks' testimony, and the documentary evidence; and finds that the creditor's allowed secured claim was provided for in full by the Hankses' Chapter 13 plan and was included in the discharge pursuant to 11 U.S.C. § 1328(a). The court finds judgment must be entered **IN FAVOR OF THE PLAINTIFFS**.

FINDINGS OF FACT

On April 18, 1997, Terry Jerome and Sandranetta Hanks borrowed $14,354.03 from

NationsCredit Financial Services Corporation of Alabama[1]. The Hankses agreed to repay the note in 84 monthly payments of $279.01 at a contract interest rate of 15.2496%. (See Proof of Claim 6 in BK 97-72646 and Plaintiffs' Exhibit 2). The first payment was due May 18, 1997, and the last due April 18, 2004. Terry Hanks secured the loan by executing a mortgage to NationsCredit on a house his grandmother gave him at 210 19th Avenue in Tuscaloosa. The mortgage documents stated the house was not the Hankses' homestead/residence. The mortgage was recorded April 23, 1997 in the real estate title records in the Tuscaloosa County Probate Office at mortgage book 1997, at page 12119. Evidence was that the property has never been the debtors' home.

The promissory note/contract, and mortgage both listed NationsCredit at 2300 McFarland Boulevard E., Ste. 8, Tuscaloosa, Alabama 35404, as lender.

September 23, 1997, the Hankses filed a Chapter 13 bankruptcy petition (BK Doc. 1). They listed both their residence at 5707 22nd Avenue East in Tuscaloosa, and the non-homestead property on 19th Avenue as Schedule A Real Property. In their Schedule D, they listed as secured creditors NationsCredit with a $14,000.00 first mortgage on the nonresidential property ; and Temple-Inland with a $69,000.00 first mortgage on their 22nd Street home. Notice of the Chapter 13 filing was served on the creditor at its Tuscaloosa address, as listed on the matrix. The debtors estimated the 19th Avenue property was worth $18,900.00 as of the petition date.

The Chapter 13 Plan Summary filed by the debtors with their schedules and dated September 22, 1997 (BK Doc. 1) provides in II. B. the following:

> II. From the payments received, the Trustee shall make disbursements as follows: ...
> B. The holder of each SECURED claim shall retain the lien securing such claim until

[1] The evidence indicates that NationsCredit was predecessor-in-interest to assignee Fairbanks Capital, itself predecessor-in-interest to the defendant SPS. See Plaintiffs' Exhibit 2.

a discharge is granted and such claim shall be paid in full with interest at a rate of 10% per annum in deferred cash payments as follows: ...

The court entered an order approving the Hankses' financial reorganization plan November 17, 1997. (BK Doc. 8) The order provided the debtors would pay Nationscredit $255.00 per month through their trustee "upon filing a properly perfected proof of claim." (Debtors Exhibit 1, AP 04-70072 and BK 97-72646 (Doc. 8)) The confirmation order further provided "secured creditors shall retain their liens securing such claim until such time as the filed and allowed claims of such creditor are paid under the terms of debtor's plan and said liens are released upon debtor's completion of the plan as confirmed or, as amended ." (BK Doc. 8) The plan proposed to pay "100% of the secured claims as determined by the Court to be secured" and 0% to unsecured creditors.

On November 21, 1997, after the confirmation order was entered, NationsCredit filed Claim No. 6 for a total "Payoff Amount" of $12,691.21.(See attachment to claim #6) The claim had been filed by its Consumer Service Center at 405 W. Loop 820 South, Suite 110, Fort Worth, TX 76108. The claim form said the payoff amount included one-month's arrearage of $279.01.

Chapter 13 Trustee C. David Cottingham filed a motion to modify the debtors' fixed payment to NationsCredit from $255.00 to the $279.01 payment required by the loan/mortgage documents submitted with Claim 6. The trustee's motion (BK Doc. 9, filed January 23, 1998) noted the obligation would be classified as a long-term debt under 11 U.S.C. § 1322(b)(5), since the last payment was due after the last payment under the Chapter 13 plan was due.

However, the debtors filed an **OBJECTION TO MOTION TO MODIFY FIXED PAYMENT** on February 4, 1998 (BK Doc. 10) stating:

> The Trustee is proposing that this debt be paid as a long term debt. The debtors' plan provided that the debt would not be a long term debt, but would be paid in full with interest

at ten (10%) percent through the Chapter 13 Plan at $255.00 per month.[2]

The record reflects no objection to either pleading from NationsCredit. The court held a hearing on the motion and objection February 20, 1998.

February 26, 1998, the court entered an order modifying the debtors' plan to pay NationsCredit out in full at the interest rate provided for in debtors' confirmed plan during the 55-month Chapter 13 plan. (BK Doc. 13). The order stated the trustee's motion was granted in that:

> NationsCredit is granted a fixed payment of $288.60 per month for a period of 55 months, for a total future value of $15,872.90 (present value of $12,691.21 plus interest at 10% APR). The debtor's objection to Trustee's motion is withdrawn.
>
> The debtor's payments are increased to $227.00 per week.

No party in interest asked for rehearing or appealed the modification of the plan in the time allowed under the Federal Rules of Bankruptcy Procedure and the Federal Rules of Civil Procedure.

The Hankses paid out their Chapter 13 plan, as amended, on July 1, 2002. (Plaintiffs' Exhibit 1, an interim statement on the account from Chapter 13 Standing Trustee C. David Cottingham).

July 9, 2002, the court entered an order discharging the Hankses of personal liability for dischargeable prepetition debt. (BK Doc. 33). In allusion to certain Bankruptcy Code provisions, the order stated:

> Pursuant to 11 U.S.C. § 1328(a), the debtor is discharged from all debts provided for by the plan or disallowed under 11 U.S.C. § 502, except any debt:
>
> > (a) provided for under § 1322(b)(5) and on which the last payment is due after the date on which final payment under the plan was due;

---

[2] 11 U.S.C. § 1322(b)(2) provides that Chapter 13 debtors may modify the rights of secured creditors (including some real estate mortgagees) in their plans except for " ... a claim secured only by a security interest in real property that is the debtor's principal residence, ..." The real estate securing NationsCredit's claim was not the debtor's principal residence.

> (b) in the nature of alimony to, or maintenance for, or support of a spouse, former spouse, or a child of the debtor in connection with a separation agreement, divorce decree or other order of a court of record, or property settlement agreement, as specified in 11 U.S.C. § 523(a)(5);
>
> (c) for a student loan or educational benefit overpayment as specified in 11 U.S.C.§ 523(a)(8);
>
> (d) for a death or personal injury caused by the debtor's unlawful operation of a motor vehicle while intoxicated from using alcohol, a drug, or another substance, as specified in 11 U.S.C. § 523(a)(9), in a case commenced on or after November 15, 1990; or
>
> (e) for restitution included in a sentence on the debtor's conviction of a crime, in a case commenced on or after November 15, 1990; or
>
> (f) for a fine included in a sentence on the debtor's conviction of a crime, in a case commenced on or after October 22, 1994.

Trustee Cottingham's Final Report and Account on the case was filed September 25, 2002. The trustee stated he had paid NationsCredit the $15,872.90 future value to satisfy the $12,691.21 payoff balance in Claim 6. See BK Doc. 34.

The Bankruptcy Court Clerk's Office closed BK 97-72646; and, in due course, sent the file to federal court archives. Sandranetta Hanks later testified the debtors discovered the creditor was still trying to collect on what they had thought was a satisfied mortgage in the spring of 2004.

Hanks told the court that the couple had entered a lease-purchase agreement to buy another house as their residence when a credit report showed they still owed an approximate $4,000.00 balance on the original NationsCredit debt; and that a satisfaction of the mortgage had never been recorded at the Probate Office. Apparently, the obligation had been reported to a credit reporting agency as delinquent. As a result, their purchase of the new house fell through when the delay forced the seller to find another buyer. The couple was living in the house they were attempting to purchase,

but had to move when the sale fell through. This was during the same week in which Mrs. Hanks was having heart surgery. Additionally, she said an adjoining property owner wished to buy the 19th Avenue house, but the sale had been stalled by the title problem.

At that point, the former debtors contacted J. Paul Whitehurst, their bankruptcy counsel. Documents in Plaintiffs' Exhibits 1 and 2 show Whitehurst then began attempting to clear Hanks' title to the 19th Avenue real estate. Both debtors' testimony and documentary evidence from the attorney's office showed months of attempts to deal with the party or entity capable of resolving the issue.

The court has deduced the following sequence of events from the record of the March 17, 2005 hearing: Whitehurst's first letter on the debtors' behalf is dated March 25, 2004, and addressed to "NationsCredit, P.O. Box 4413, Jacksonville. FL 32231".[3] The account number listed was C81432758, the account number on the original note between NationsCredit and the debtors, submitted by NationsCredit with Claim 6. As shown by Plaintiffs' Exhibit 1, the letter included copies of the confirmation order, Chapter 13 payment records, and the discharge order. It stated:

> ... On behalf of the Hanks I hereby demand that you immediately satisfy or release the mortgage. If you need any further records or assistance in this matter please contact me immediately.

Chronologically, the next communication in Exhibit 1 was a facsimile message from Whitehurst's assistant, Kristi Bardon, to the NationsCredit's "Customer Advocate Department" at 1-904-232-4607 on April 27, 2004 stating:

---

[3] The court notes that copies of documents in the debtors' exhibits are what they are. They were not verified as correct and accurate business records by the defendant; nor did any agent for the creditor swear to the veracity of their contents. The plaintiffs and their counsel identified the documents as communications they received in their attempts to have the mortgage released.

> Please review the attached evidence (apparently the previous correspondence), and kindly satisfy Mr. & Mrs. Hanks' mortgage. Please mail them their satisfied deed and mortgage as soon as possible.
>
> If you have any questions, or need additional information please contact us. Your prompt attention to this request is greatly appreciated.

By this point, the loan account number on the fax cover sheet had been changed to "7001661425".

The law office apparently received an unsigned letter dated May 4, 2004 from "Consumer Affairs Department" for an entity listed in the letterhead as "Fairbanks Capital Corp." at 10401 Deerwood Park Blvd. Jacksonville FL 32256" and "Loan Servicing Center" at "10401 Deerwood Park Blvd./P.O. Box 551170, Jacksonville, Florida 32256."[4] This communication also referenced the 7001661425 account number, but listed its fax as "904-232-4626." The creditor did not respond to Whitehurst's demands with a "yes" or a "no". The letter stated the following:

> Fairbanks Capital Corp. Consumer Affairs Department has received your letter dated April 27, 2004, which raises issues regarding the mortgage loan referenced above.
>
> Fairbanks recognizes the importance of providing a prompt and thorough response to the concerns addressed in the letter. Please be assured that we will contact the appropriate persons and reply to your inquiry within thirty (30) business days of your receipt of this letter.
>
> If you you have any additional questions, please contact Walter Fudge Jr., Consumer Advocate at (866) 878-5178x27732. (emphasis added)

Documents included in Exhibit 1 show that on August 30, 2004, almost four months after Fairbanks stated they would reply with thirty business days, Bardon faxed another message to "Consumer Affairs Department" of Fairbanks Capital, this time including "**ATTENTION: Supervisor"** in the salutation. The message states:

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[4] Trustee Cottingham's final report showed he sent $15,872.90 to Nationscredit at "P.O. Box 551170, Jacksonville, Florida 32256", the amount the creditor was due under the Hankses' plan.

> Attached you will find our original fax to you concerning the above account, a response letter dated 5/4/04, and a log showing the dates I have attempted to follow up on this matter.
>
> Our clients need this matter taken care of. Mr. Fudge's letter stated we would hear from him in 30 days. I have called him 5 times with no return call.
>
> Your attention to this matter would be greatly appreciated.

The log referred to states the following:

> 6/21/04 – spoke to our client he has not received his Satisfaction of Mortgage. Call to Mr. Fudge at Fairbanks Capital – left message for him to return my call.
>
> 6/28/04 – left message for Mr. Fudge to return my call re Terry Hanks
>
> 7/15/04 – left message for Mr. Fudge to return my call re Terry Hanks
>
> 8/25/04 – 8:30 a.m. CST – called Mr. Fudge and asked him to return my call ASAP
>
> 8/30/04 – Called Mr. Fudge left message for him to call me, or to direct me to the correct person for help.
>
> Fax to Consumer Advocate Supervisor

Exhibit 1 shows that the next communication from a creditor entity came September 20, 2004. It was a facsimile with a cover sheet under the letterhead "**SPS/SELECT *Portfolio* SERVICING, *inc.***" It was identified as "Dispute Response from Walter Fudge". The cover sheet showed the documents were transmitted September 20, 2004. The "response" was another unsigned letter dated June 15, 2004, purportedly from "Walter G. Fudge Jr.", this time identified as "Customer Advocate", on the Fairbanks letterhead and again stating the Jacksonville address.

The text of the document states that "servicing" was transferred to Fairbanks April 1, 2002. The document contended that an unpaid balance of $4,194.26 was still owed on the loan due to interest accruals applied by the "the prior servicer" on the loan. The unsigned letter does not identify the "prior servicer" by name or explain its relationship with the loan contract and/or mortgage

between the original creditor NationsCredit and the Hankses.

The letter informed Whitehurst that "we" would refuse to file a satisfaction of mortgage until the claimed $4,194.26 was paid:

> We are unable to file a Satisfaction of Mortgage prior to the loan being paid in full. Currently the account has a $4,194.26 unpaid principal balance. Once the account has been paid in full, the Satisfaction of Mortgage will be filed with the required county for recording and the final Satisfaction of Mortgage will be mailed to the customer. .

The letter stated that a request "has been submitted" to its "Payoff Department" to provide Whitehurst with a free copy of the payoff figures. The letter also stated that this would take another week, to a week-and-a half.

The last document in Plaintiffs' Exhibit 1 is a copy of Whitehurst's September 24, 2004 letter, this time addressed to a named individual, "Ms. Katherine Manning, Select Portfolio Servicing, Inc., P.O. Box 65250, Salt Lake City, UT 84165-0250". The letter stated the following:

> I am enclosing a copy of my previous letter concerning this loan with the attachments. I am also enclosing the response from Walter Fudge that was only received this week. Finally, I am enclosing a copy of my letter today and the proposed complaint.
>
> If you need anything further, please contact me.

On October 5, 2004, Whitehurst, on the debtors' behalf, filed the complaint commencing this adversary proceeding (AP 04-70072). It asked this Bankruptcy Court to hold Select Portfolio Servicing, Inc. (formerly known as Fair Banks Capital Corp., according to the complaint) in contempt of this court's 11 U.S.C. § 524 discharge order for its collection attempts, including its refusal to release the mortgage recorded against the real estate.

The plaintiffs requested sanctions for the alleged misconduct, including payment of their attorneys fees and expenses; and damages for their losses and mental anguish. The plaintiffs asked

the court to enjoin the creditor from further collection efforts against them and:

> Order the Defendant to establish reasonable procedures to prevent future violations of discharge orders in its mortgage loan collection system. This includes establishing procedures to identify what mortgage loans are discharged, establishing procedures that will require prompt release of mortgage liens and discontinuance of collection efforts.

The Bankruptcy Clerk's Office issued the summons on Select Portfolio Service, Inc. October 5, 2004, setting a November 4, 2004 deadline for its answer. (AP Doc. 2) The record reflects that the summons service was executed on defendant SPS on October 14, 2004. (AP Doc. 6).

Plaintiffs' Exhibit 2 shows that Whitehurst's office received another communication from SPS dated October 15, 2004. It was also in letter form (with attachments) and appears to be signed (not legibly to the court) over the typed name of "David Hartzell" "Customer Advocate". Although this message is on the SPS business letterhead/logo, the address at the bottom of page one is the street number and post office box mailing address seen on the communication over "Walter G. Fudge Jr.'s" name under the Fairbanks Capital Corp. letterhead. It is also the post office box where the trustee mailed the Hankses' payments. (See bankruptcy document #34). It stated:

> As your original correspondence dated March 25, 2004 was addressed to NationsCredit, the following information is provided. Fairbanks Capital Corp. acquired the servicing rights for the Hankses' account from NationsCredit Financial Services Corporation on April 1, 2002. Please note that the correct loan number of 7001661425 remained the same. Effective July 1, 2004, Fairbanks Capital Corp. changed its name to Select Portfolio Servicing, Inc. (SPS). Although our name is new, the company that services the Hankses' account has not changed. The payment address and toll free numbers remain the same.

The letter did not mention the lawsuit, and again refused to satisfy the mortgage. It made various responses to Whitehurst's allegations. The letter referred the debtors to numerous different SPS departments with numerous different telephone numbers in at least 3 different cities in 3 states for definitive information on different aspects of the 2-page contract/note.

This post lawsuit communication included a document labeled a SPS "Payoff Quote" issued June 22, 2004, of $5,452.24 including the $4,194.26 principal balance, interest calculated to July 8, 2002 (when the Chapter 13 trustee made the last plan payment), "Escrow/Impound Advance Balance, Unpaid Late Charges, Funds Advanced on Borrower's Behalf, and Recording Fee, for a total balance due of $5,452.24 as of July 8, 2004. The document noted that the figure would expire July 8, 2004. The document also said SPS would continue to charge $1.17 a day in interest, and a 50-cents per month late charge. The correspondence dated October 15, 2004, stated:

> As stated in our response dated June 15, 2004, we are unable to file a Satisfaction of Mortgage prior to the loan being paid in .full.

Nevertheless, SPS did not file an answer to the adversary complaint as of November 4, 2004, nor did it do so thereafter.

On December 7, 2004, the Hankses filed an application for entry of default in this lawsuit (AP Doc. 7), stating that CPS had filed no answer or other responses as required by the Federal Rules of Bankruptcy Procedure. The Bankruptcy Clerk's Office entered the default on December 9, 2004 (AP Doc. 8). The defendant did not respond to AP Docs. 7 or 8.

The court signed and entered a default judgment/rule to show cause on February 8, 2005 (AP Doc. 11) ordering CPS to appear at a March 17, 2005 hearing to show cause why it should not be held in contempt.

March 17, 2005, the debtors and counsel appeared for the hearing and offered both documentary evidence and testimony as to the allegations in the complaint. SPS failed to appear March 17, 2005, nor did it respond to the court's order or defend against the plaintiffs' allegations in any other way. The archived file of BK 97-72646 was not available to the court on the hearing date.

The bankruptcy file was later retrieved and reviewed by the court before its final decision.

The court made certain oral findings of fact from the bench and noted some provisions of the Bankruptcy Code as well. This memorandum includes a memorialization and expansion on the record facts; and final conclusions of law on the dispute.

CONCLUSIONS OF LAW

This court has jurisdiction of Terry Jerome and Sandranetta Hankses' Chapter 13 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this contempt-of-court/sanctions action, a core bankruptcy proceeding arising under 11 U.S.C. §§ 524(a) and 105(a), pursuant to 28 U.S.C. § 1334(b). Jurisdiction is referred to this Bankruptcy Court by the General Order of Reference of the United States District Courts for the Northern District of Alabama, signed July 16, 1984, As Amended July 17, 1984.

I.

The Eleventh Circuit Court of Appeals has held bankruptcy courts have both inherent and statutory authority to enforce their discharge injunctions.

A debtor's discharge order operates as an injunction against subsequent attempts to enforce the discharged debt as a personal liability of the debtor. 11 U.S.C. § 524(a)(2) provides the following:

(a) A discharge in a case under this title –

> (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; ...

As noted by the Eleventh Circuit Court of Appeals in two related 1996 opinions, bankruptcy courts have both inherent powers to punish violations of their orders and a special statutory empowerment in 11 U.S.C. § 105(a). One of the cases involved alleged violation of the discharge

injunction; the other, alleged violation of the stay. In both, the appeals court elected to use the specific statutory authority under Section 105(a). That rule was first stated in Jove Engineering, Inc.v. Internal Revenue Service (In re Jove Engineering, Inc.), 92 F.3d 1539, 1554 (11th Cir. 1996), involving violation of the Section 362 stay.

Less than two months later, the court restated the principle in Hardy v. United States (In re Hardy), 97 F.3d 1384 (11th Cir. 1996), involving violation of the Section 524 discharge injunction. In making these decisions, the appeals court relied heavily on International Union, United Mine Workers of America v. Bagwell, 512 U.S. 821 (1994). See also Lucre Management Group, L.L.C. v. Schempp Real Estate, L.L.C. (In re Lucre Management Group, L.L.C.), 365 F.3d 874 (10th Cir. 2004) and Armstrong v. Rushton (In re Armstrong), 304 B.R. 432 (10th Cir. BAP 2004); and In re Arnold, 206 B.R. 560 (Bankr. N.D. Ala. 1997)(court levied damages, including $15,000.00 in punitive damages under court's inherent powers on finding of bad faith, malevolent intent).

The appeals court stated:

> The Supreme Court has warned that a court must "exercise caution in invoking its inherent power," stating:
>
> > Because of their very potency, inherent powers must be exercised with restraint and discretion. A primary aspect of that discretion is the ability to fashion an appropriate sanction for conduct which abuses the judicial process. ... [W]hen there is a bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power. But if in the informed discretion of the court, neither the statute nor the Rules are up to the task, the court may safely rely on its inherent power.
> >
> > Chambers v. NASCO, Inc. 501 U.S. 32, 44-45, (1991).
>
> Instead of grounding liability for violation of the permanent stay in the court's inherent contempt powers and § 524, we exercise the caution recommended by the Court in Chambers and rely on the other available avenue for relief, statutory contempt powers under § 105.

Hardy, 97 F.3d at 1390.

11 U.S.C. § 105(a) itself provides the following:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

The Internal Revenue Service was the defendant in both Jove and Hardy. In the latter case, the plaintiff Hardy had paid IRS the full $11,640.99 amount of its allowed claim before he was discharged of his debts April 5, 1991. After receiving its copy of the discharge order, IRS nevertheless attempted to collect $4,109.31 of the debt. Despite contacts from the debtor's attorney, the agency levied on the former debtor's bank account. It then sent an agent to his home who collected a $3,465.61 payment to "settle" the debt. Nevertheless, the IRS filed another levy in an attempt to collect. The debtor sued for damages under Sections 524(a)(2) and 105(a).

The court also discussed liability under Section 105 in Hardy:

> While a defendant may by cited for contempt under the court's inherent powers only upon a showing of "bad faith," Mroz, 65 F.3d at 1575, IRS may be liable for contempt under § 105 if it willfully violated the permanent injunction of § 524. Jove. 92 F.3d at 1553-54, see Havelock v. Taxel (In re Pace), 67 F.3d 187, 193 (9th Cir. 1995). This court has stated that "the focus of the court's inquiry in civil contempt proceedings is not on the subjective beliefs or intent of the alleged contemnors in complying with the order, but whether in fact their conduct complied with the order at issue." Howard Johnson Co. V. Khimani, 892 F.2d 1512, 1516 (11th Cir. 1990) (quoted in Jove, 92 F.3d at 1554). In Jove, this court adopted a two-pronged test to determine willfulness in violating the automatic stay provision of § 362. Under this test the court will find the defendant in contempt if it: "(1) knew that the automatic stay was invoked and (2) intended the actions which violated the stay." Jove, 92 F.3d at 1555. This test is likewise applicable to determining willfulness for violations of the discharge injunction of § 524.

Hardy, 97 F.3d at 1390.

The Eleventh Circuit court emphasized that the bankruptcy court could only levy sanctions

for contempt as a civil remedy, not the punitive sanctions available only in criminal contempt cases:

> The court may only impose sanctions for contempt that are coercive and not punitive, Jove, 92 F.3d at 1557-58. In determining whether a sanction for contempt is coercive, the court must ask "(1) whether the award directly serves the complainant rather than the public interest and (2) whether the contemnor may control the extent of the award." Id. If the court finds, as in Jove, that the appellant primarily seeks monetary damages in the form of a fixed non-compensatory fine, then the court may not order such monetary damages, as they are punitive and not coercive.

Hardy, 97 F.3d at 1390.

Generally, to establish a case for civil contempt, the plaintiff must prove by "clear and convincing" (not a preponderance of) evidence that a valid court order was violated. See Jove, 92 F.3d at 1545.

In order to determine if SPS violated a valid order of the court, the court must analyze the relation of the parties prepetition, during the term of the confirmed plan, and after the debtors completed their plan and were discharged.

II.

Chapter 13 debtors can modify the rights of secured creditors, including those secured by non-homestead real estate. They may choose to accelerate the debts to pay them out through their plans; or they may maintain payments as long-term debt enforceable after discharge.

With certain exceptions, the Bankruptcy Code allows Chapter 13 debtors to modify the non-bankruptcy law rights of secured creditors. As public policy, Chapter 13 attempts to give debtors an incentive to pay at least part of their debts during a reorganization, rather than filing for a Chapter 7 liquidation. The applicable provisions attempt to balance the debtor's Chapter 13 "fresh start" with the interest of creditors, while protecting the asset distribution system created by Congress.

Many Chapter 13 debtors have secured debts encumbering real estate, residential and

otherwise; and encumbering personal property in which the terms of the loan extend beyond the maximum 60 months allowed for completion of a Chapter 13 reorganization. The Bankruptcy Code gives debtors options for these debts which are unavailable under state or other non-bankruptcy law. 11 U.S.C. § 1322 which sets both mandatory and permissive contents for Chapter 13 debtors' reorganization plans, contains some of those options.

Section 1322(a) requires that the plan "shall": (1) submit all the debtors' disposable income to the trustee for distribution to creditors; (2) provide for the full payment in deferred cash payments of all priority payments under section 507; and (3) if the plan classifies claims, provide the same treatment for each claim in a particular class. Section 1322(b) then provides 10 actions that the plan "may" do. For example, 11 U.S.C. §§ 1322(b)(2) and (5) provide the following:

> (b) Subject to subsections (a) and (c) of this section, the plan may–
>
> > (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; ...
> >
> > (5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due; ...

These sections provide a debtor two choices for long-term debt secured by non-homestead real estate. He or she may "cure" prepetition arrearage while continuing regular payments to the creditor as long-term debt under Section 1322(b)(5). Or he or she can modify the terms of the contract under Section 1322(b)(2), accelerate the debt, and pay the allowed, secured claim in full during the plan. The debtors in this case chose the second option of modifying the terms of the mortgage under 1322(b)(2), rather than curing and maintaining the mortgage payments under Section 1322(b)(5). The

debtors chose this same option in the case of Homebanc, Incorporated v. Chappell (In re Chappell), 984 F.2d 775, 780 (7th Cir. 1993). The court in Chappell at page 780 stated:

> The language of section 1322(b)(5) is discretionary, and a debtor may choose to treat a long-term debt in accordance with its terms. See Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1226 (8th Cir. 1987) ("A debtor may, but is not required to, provide for his long-term debts by using this provision.") In re Ali, 63 B.R. 591.593 (Bankr. E.D. Wis. 1986) (stating that the section is permissive in nature). Pursuant to that section "[n]ot all long-term debts are entitled to be excepted from discharge ... but only those debts which the debtor wishes to continue treating as long-term debts." In re Smith, 8 B.R. 543, 547 (Bankr. D. Utah 1981).

See also Holloway v. Southeast Alabama Medical Center (In re Holloway), 261 B.R. 490 (M.D. Ala. 2001) and Zabel v. Schroeder Oil, Inc. (In re Zabel), 249 B.R. 764 (Bankr. E.D. Wisc. 2000), (both Chapter 12 cases using Chapter 13 precedent); In re Stovall, 256 B.R. 490 (Bankr. N.D. Ill., 1999); and In re James, 285 B.R. 114 (Bankr. W.D. N.Y. 2002) (loan secured by automobile).

Debtors' plan, as filed with their schedules, indicated in paragraph 1 that they were not treating NationsCredit as a long term debt. Paragraph number 2 under "other secured debts" included NationsCredit with a scheduled indebtedness of $14,000.00 to be paid at 10% interest with a fixed payment of $200.00 per month. After the case was confirmed NationsCredit filed claim #6 showing a balance of $12,691.21. The trustee filed a motion to modify the debtors' plan to treat this claim as a long term debt under Section 1322(b)(5) (Bk Doc. 9). NationsCredit was served with a copy of the trustee's motion. The debtor objected to this motion to modify and reiterated that his plan proposed to pay the indebtedness in full at 10% interest at the rate of $255.00 per month as set out in the order of confirmation. (Bk Doc. 10) NationsCredit was also served with this objection. A hearing was held on the trustee's motion and the debtor's objection on February 20, 1998. NationsCredit failed to appear and an order was entered providing that the claim of NationsCredit would be paid in full over a period of 55 months at the rate of $288.60 per month at 10% interest. (Bk Doc. 13) NationsCredit

was served with a copy of this order and failed to appeal.

NationsCredit was clearly on notice that the debtors proposed to pay their claim in full within the term of the plan. NationsCredit had a copy of the debtors' plan, confirmation order, the trustee's motion with the debtors' objection, and the order which was entered following the hearing on the debtor's objection. None of these could have led NationsCredit to believe that the debtor was treating their claim as a long term debt under Section 1322(b)(5).

Pursuant to 1322(b)(2) the debtor chose to pay the claim of NationsCredit over a period of 55 months at an interest rate of 10%, rather than pay NationsCredit as a long term debt under 1322(b)(5) over 84 months at the interest rate of 15.2496% as provided in the note.

1322(b)(2) allows the debtor to modify the rights of NationsCredit. Section 1325 provides that a plan shall be confirmed if certain provisions are made in the plan. 1325(a)(5) provides:

> **1325. Confirmation of plan**
> (a) Except as provided in subsection (b), the court shall confirm a plan if - ...
> (5) with respect to each allowed secured claim provided for by the plan-
> (A) the holder of such claim has accepted the plan;
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
> (C) the debtor surrenders the property securing such claim to such holder; and ...

NationsCredit did not object to the plan, but that is not the same as having accepted the plan. So 1325(a)(5)(A) does not apply. The debtor did not surrender the property to the secured creditor, NationsCredit, so 1325(a)(5)(C) does not apply. Therefore, the plan was due to be confirmed if it complied with 1325(a)(5)(B).

The chapter 13 plan summary filed by the debtor with his schedules and dated September 22,

1997 provides in II. B. the following:

> II. From the payments received, the Trustee shall make disbursements as follows:
> B. The holder of each SECURED claim shall retain the lien securing such claim until a discharge is granted and such claim shall be paid in full with interest at a rate of 10% per annum in deferred cash payments as follows: ...

(BK Doc. 1)

The plan therefore complied with 1325(a)(5)(B). The confirmation order entered in this case (Bk Doc. 8) further provided "Secured creditors shall retain their liens securing such claim until such time as the filed and allowed claims of such creditor are paid under the terms of debtor's plan and said liens are released upon debtor's completion of the plan as confirmed or, as amended...". No appeal was filed by NationsCredit from this order of confirmation.

Debtor's plan, as confirmed, complied with the requirements of 1322(b)(2) and 1325(a)(5). Debtor completed all payments under the terms of the confirmation order and received his discharge. The claim of NationsCredit was paid under the terms of the debtor's plan and pursuant to the terms of the confirmation order "said liens are released upon debtor's completion of the plan as confirmed...". NationsCredit asserted no claim for any additional indebtedness due from the debtors after the debtors' plan was confirmed and prior to the entry of the debtors' discharge, a period of almost five years. "A lien on property only exists to secure payment of a specific debt. In re Echevarria, 212 B.R. 26, 28 (Bankr. D.P.R.). aff'd. 212 B.R. 185 (1st Cir. BAP 1997), aff'd. 141 F.3d 1149 (1st Cir. 1998). Liens do not survive bankruptcy where the debt is provided for in the plan and is paid in full. Id." In re Stovall, 256 B.R. 490, 493 (Bankr. E.D. Ill. 1999). See also Chappell, 984 F.2d 775 (7th Cir. 1993).

III.

Select Portfolio Services, Inc. violated the 11 U.S.C. Section 524 discharge injunction by continuing to demand payment of a discharged debt before releasing its lien.

The bankruptcy court had provided NationsCredit a copy of the confirmation order, the court's order providing that its claim would be paid at 10% interest over 55 months, and a copy of the debtors' discharge when the plan was completed. Select Portfolio Services, Inc., as successor to NationsCredit, was also provided copies of all documents by debtors' attorney on at least two occasions beginning in April, 2004. The confirmation order provided that this lien was released upon completion of the debtors' plan and yet Select Portfolio Services, Inc. refused to release its lien on the debtors' real estate and asserted that it was still owed approximately $5,000.00.

In 1997, the Bankruptcy Court for the Middle District of Alabama, faced an issue similar to that in the Hankses' case. Judge Rodney R. Steele required a mortgagee to file a satisfaction based on the authority of Fed. R. Bankr. P. 7070[5], and Fed. R. Civ. P. 70, as well as Section 105(a). See In

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[5] **Rule 7070. Judgment for Specific Acts; Vesting Title.**

Rule 70 FR Civ P applies in adversary proceedings and the court may enter a judgment divesting the title of any party and vesting title in others whenever the real or personal property involved is within the jurisdiction of the court.

Rule 70. Judgment for Specific Acts; Vesting Title.

If a judgment directs a party to execute a conveyance of land or to deliver deeds or other documents or to perform any other specific act and the party fails to comply within the time specified, the court may direct the act to be done at the cost of the disobedient party by some other person appointed by the court and the act when so done has like effect as if done by the party. On application of the party entitled to performance, the clerk shall issue a writ of attachment or sequestration against the property of the disobedient party to compel obedience to the judgment. The court may also in proper cases adjudge the party in contempt. If real or personal property is within the district, the court in lieu of directing a conveyance thereof

re Anderson, 206 B.R. 573, 575 (Bankr. M.D. Ala. 1997). The court was enforcing its own order approving a settlement by which the debtor agreed to pay the mortgagee $12,500.00 during the course of his Chapter 13 plan. In return, the order required the mortgagee to file proper satisfaction documents and to discharge the indebtedness.

The court found the debtor had paid the full amount in his Chapter 13 plan, but that the creditor had failed to file the satisfaction. The creditor also failed to respond to the court's order to show cause, or to the debtor's motion for an accounting. The Bankruptcy Court, after a hearing, gave the mortgagee 30 days to record the documents necessary to clear the title.(The creditor did not appear at the hearing to defend.) The court ordered:

> If James R. Barnes fails to do all acts necessary to satisfy of record the real estate mortgage of the above described real estate in the debtor, then this order shall stand, pursuant to Rule 70 of the Federal Rules of Civil Procedure, incorporated as Rule 7070 of the Bankruptcy Rules, as a judgment satisfying the mortgage of the above described real estate from James R. Barnes in favor of the debtor, Willie James Anderson. This judgment has the effect of conveyance executed in due form of law and is a satisfaction of the mortgage for recommendation purposes.

Anderson, 206 B.R. at 574-75.

11 U.S.C. Section 524 provides the debtor with a post discharge injunction against collection of debts which have been discharged in the bankruptcy case. Section 524 provides:

> **§ 524. Effect of discharge**
> (a) A discharge in a case under this title-
> (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived;

> may enter a judgment divesting the title of any party and vesting it in others and such judgment has the effect of a conveyance executed in due form of law. When any order or judgment is for the delivery of possession, the party whose favor it is entered is entitled to a writ of execution or assistance upon application to the clerk.

and...

The debtor having successfully completed all terms under his plan and having received a discharge, was due to have NationsCredit's lien released. Instead, Select Portfolio Services, Inc. as its successor, demanded in excess of $5,000.00 in order to release a lien which had been discharged pursuant to the court's order and the Bankruptcy Code.

> This court has stated that "the focus of the court's inquiry in civil **contempt** proceedings is not on the subjective beliefs or intent of the alleged contemnors in complying with the order, but whether in fact their conduct complies with the order at issue." Howard Johnson Co. V. Khimani, 892 F.2d 1512, 1516 (11th Cir. 1990)(quoted in Jove, 92 F.3d at 1554). In Jove, this court adopted a two-pronged test to determine willfulness in violating the automatic stay provision of § 362. Under this test the court will find the defendant in **contempt** if it: "(1) knew that the automatic stay was invoked and (2) intended the actions which violated the stay." Jove, 92 F.3d at 1555. This test is likewise applicable to determining willfulness for violations of the **discharge injunction** of §524.

Hardy at 1390.

Select Portfolio was aware of the court's confirmation order and order of discharge, having been notified both by the court and by debtors' counsel and provided copies of these orders. Select Portfolio evidenced its intentions to not comply with these orders by its written communications to debtors' counsel demanding payment of a discharged debt before releasing a lien which had been discharged.

CONCLUSION

The court finds that the Hanks have satisfied their indebtedness to Select Portfolio Services, Inc., as successor to NationsCredit, and that the mortgage recorded in Deed Book 1997 at page 12119 is due to be marked satisfied in the real estate records of Tuscaloosa County, Alabama. The court finds that Select Portfolio Services, Inc. is in contempt of court for continuing to attempt to collect

from the debtors a previously discharged debt and for failing to satisfy the mortgage on debtors' property pursuant to the terms of the confirmation order. The court further finds that the Hanks have incurred attorney fees in prosecuting this action in an undetermined amount and that the attorney for the Hankses shall submit to the court within 14 days an itemized statement reflecting dates of service, nature of service, and time spent for the prosecution of this action.

An order consistent with these findings pursuant to F.R.B.P 7052 will be entered separately.

DONE and ORDERED this July 7, 2005.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

ROBERT C. CAFFEE, **BK 04-73228-CMS-13**

DEBTORS.

ACCEPTANCE LOAN COMPANY, INC. **AP 05-70003-CMS**

PLAINTIFF,

vs.

ROBERT CAFFEE
and SHIRLEY CAFFEE,

DEFENDANTS.

MEMORANDUM OF DECISION

This matter was before the court on Robert Caffee's motion to remand this removed lawsuit back to state court, and on creditor Acceptance Loan Company, Inc.'s opposition to remand. The court has reviewed the evidence in the context of applicable law.

FINDINGS OF FACT

Acceptance Loan Company, Inc. commenced this lawsuit March 4, 2004 with a collection complaint against Robert and Shirley Caffee filed in the District Court of Tuscaloosa County, Alabama. (DV 2004-350, attachment to AP Doc. 1) The creditor was seeking to collect on a delinquent promissory note the Caffees owed. On March 22, 2004, the Caffees responded by filing a notice of removal to the Circuit Court, along with an answer and a notice of filing a counterclaim as a potential class action. The case was transferred to Circuit Court because the amount in

controversy exceeded the District Court's $10,00.00 jurisdictional limit. (CV 2004-559, attachment to AP Doc. 1).

The Caffees alleged in their counterclaim that Acceptance had violated the Consumer Credit Protection Act (15 U.S.C. § 1681 a-2), the Fair Credit Reporting Act (15 U.S.C. § 1681s-2), and the Truth in Lending Act (15 U.S.C. § 1601, et seq.). Their complaint also sets forth state law claims for breach of contract, fraud, and conversion; and sought a declaratory judgment. Circuit Judge Charles Malone denied Acceptance Loan's motions to dismiss and to compel arbitration of the counterclaim. Subsequently, the creditor filed its answer to the counterclaim July 29, 2004.

On October 19, 2004, the Caffees filed a petition under Chapter 13 of the Bankruptcy Code seeking a reorganization of their finances. The debtors referred to the state court action in their Schedule B. Personal Property filed with their petition (BK Doc. 1), stating:

> Atty Gene Moore is filing a class action suit against Acceptance Loan for fraud – no market value.

The Caffees did not claim the cause of action as exempt in the Schedule C filed with the petition. On Schedule F, they listed Acceptance Loan Co. as an unsecured creditor owed $3,600.00. On November 16, 2004, Acceptance Loan Co. filed Proof of Claim 6 for $5,470.30.

This lawsuit had been pending in Circuit Court for eight months when the Caffees filed bankruptcy. The state court had ruled on the dismissal and arbitration issues and both parties had engaged in some discovery. However, the case had not yet reached the stage where the court had begun to address the merits.

On January 14, 2005, Loan Acceptance filed its notice of removal of the suit/counterclaim

to Bankruptcy Court under 28 U.S.C. §1452[1]. Upon the filing, CV 2004-559 became Adversary Proceeding 05-70003 in the Bankruptcy Court.

The Caffees' filed their motion asking for remand to the Circuit Court; and/or, in the alternative, for this court to abstain from hearing the case on February 1, 2005. (AP Doc. 7) On February 9, 2005, this court entered an order dismissing Shirley J. Caffee from BK 04-73228. (BK Doc. 51). (Ms. Caffee later filed an individual Chapter 13, BK 05-71115 in which confirmation is pending.) On March 8, 2005, Acceptance Loan filed its opposition to the plaintiffs' motion. (AP Doc. 10) The court took the remand/abstention issues under submission for a decision as of March 10, 2005. (AP Doc. 11, Minute Entry)

On March 23, 2005, this court entered an order confirming Robert C. Caffee's Chapter 13 plan. (BK Doc. 67). The order provided for a $114.00 per-month payment to Acceptance Loan for Proof of Claim No. 6 including 6% interest over the 60-month term of the plan. The plan stated that unsecured creditors would be paid pro-rata from funds left, after the secured creditors received fixed payments, up to a total of $928.00. The order also stated:

> By agreement, in the event the debtor(s) receives any money from the lawsuit scheduled then the money recovered above the amount claimed exempt shall be paid to the Chapter 13 Standing Trustee to be distributed to Creditors.

CONCLUSIONS OF LAW

This court has jurisdiction of debtor Robert C. Caffee's Chapter 13 case pursuant to 28

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[1] **28 U.S.C. § 1452(a)** provides the following:

> (a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title. ...

U.S.C. § 1334(a). It has jurisdiction of this lawsuit pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court, pursuant to 28 U.S.C. 157(a) by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, as amended July 17, 1984.

I.

This court has "related-to" jurisdiction of this removed lawsuit, and may weigh equitable factors to decide whether to exercise the jurisdiction.

In every lawsuit removed to bankruptcy court under 28 U.S.C. 1452(a)[2], the first issue to be decided is whether the court has jurisdiction pursuant to 28 U.S.C. § 1334(b). St. Vincent's Hospital v. Norrell (In re Norrell), 198 B.R. 987, 992 (Bankr. N.D. Ala. 1996). Section 1334(b) provides that district courts, and through them, the bankrupt courts have "original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11."

Since the causes of action in this lawsuit and counterclaim are not created by, nor to be determined by the Bankruptcy Code, the case does not come under the "arising under" classification in Section 1334(b). Since the suit could, and did, exist outside the bankruptcy context, is cannot be classified under "arising in" 1334(b) jurisdiction. Norrell, 198 B.R. at 993.

However, the third Section 1334(b) classification requires only that the civil action be "related to a case under title 11." In this circuit, the definition of "related-to" was annunciated in Miller v. Kemira Inc. (In re Lemco Gypsum, Inc.), 910 F.2d 784, 788 (l1th Cir. 1990), citing Pacor,

[2] Section 1452(a) permits removal to bankruptcy courts "if such district court has jurisdiction of such claim or cause of action pursuant to section 1334 of this title." Some courts have disagreed on whether it is proper for a party to remove an action directly to the bankruptcy court as opposed to the district court above. The General Order of Reference from the United States District Court for the Northern District of Alabama makes direct removal appropriate.

Inc. v. Higgins, 743 F.2d 984,994 (3rd Cir. 1984):

> "The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of the proceeding could conceivably have an effect on the estate being administered in bankruptcy. The proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options and freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate."

See also Continental National Bank of Miami v. Sanchez (In re Toledo), 170 F.3d 1340 (11th Cir. 1999).

Acceptance Loan's original lawsuit alleged that the Caffees were liable for non-payment on an open account held by the creditor. Then the Caffees, in their counterclaim alleged various violations of non-bankruptcy federal law relating to consumer credit; and other violations of Alabama state law. The counterclaim also seeks money damages.

While all these causes of action are independent of the Bankruptcy Code, the outcome of the litigation will clearly impact administration of Robert C. Caffee's Chapter 13 estate.

If the Caffees are liable for the debt, and unsuccessful on their counterclaim, the trustee's distribution will be made according to terms of the confirmed Chapter 13 plan. However, to the extent the Caffees are not liable for the debt, any payment to Acceptance would be reduced or even nullified by that finding. In that case, money would be available for other unsecured creditors, increasing their distribution under the plan. Additionally, if the Caffees prevail on the merits of the counterclaim and are awarded money damages, those funds would also become property of the estate to be shared by creditors.

This civil action is related to a bankruptcy case in the contemplation of the 28 U.S.C. § 1334(b) jurisdictional grant.

The second section of 28 U.S.C. § 1452 allows bankruptcy courts broad discretion about

whether or not to remand such a case or to exercise the jurisdiction. Section 1452(b) states:

> (b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. (emphasis added)

II.

In this case, the equities require remand to state court.

The Bankruptcy Court will not reach the issue of mandatory abstention, since the balance of the equities under Section 1452(b) so clearly require remand to state court. The Fifth Circuit Court of Appeals set out eight factors to be considered in making the remand/retain decision in Browning v. Navarro, 743 F.2d 1069, 1076 at n. 21 (5th Cir. 1984).

This court's paraphrase of those factors includes the following:

1. Does removal create a forum non conveniens problem – or vice versa?

2. If a civil action has been bifurcated by removal, the entire action should be tried by the same court.

3. Is a state court better able to respond to questions involving state law?

4. Does either court have expertise that would be particularly useful in trying the removed civil action?

5. Will use of two forums result in duplicative and uneconomical use of judicial resources?

6. Consideration should be given to prejudice to the involuntarily removed parties.

7. As in all such determinations, the court should be sensitive to considerations of comity with the state court system.

8. As much as possible, the court's remand decision should lessen the possibility of inconsistent result.

Wilson v. ALFA Companies (In re Wilson), 207 B.R. 241, 249 (Bankr. N.D. Ala. 1996).

This court analyzes Acceptance Loan v. the Caffees in the context of the Browning factors as follows:

1. Forum non conveniens: The United States Bankruptcy Court and the Tuscaloosa County Circuit Court are located on the same street in Tuscaloosa, Alabama. The forum is the same geographically. However, the jury request and nature of the complaints would require transfer from this Bankruptcy Court after pretrial motions are decided to the District Court above. Some District Court jury trials are tried in Tuscaloosa, but most are held in downtown Birmingham, Alabama, approximately 50 miles away.

2. Bifurcation by removal: Retention of the case by the bankruptcy court would require bifurcation between this court for pretrial proceedings; and the District Court for the merits before a jury. In state court, the same judge could rule on pretrial motions, and then preside over the jury (fact finding) phase of the case.

3. Question of state law: Both the bankruptcy courts and state courts routinely handle state law issues in areas affecting the finances of individuals and businesses.

4. Expertise of the particular court: The state courts, the district courts, and the bankruptcy courts regularly handle cases of this nature. However, the state court circuit judge has already denied a motion to dismiss and a motion to arbitrate the case. It appears the circuit court is already more familiar with the facts and law than the federal courts.

5. Uneconomical use of judicial resources: Although Section 1452 is the means by which the creditor moved into the Bankruptcy Court, no core bankruptcy proceedings are involved and none of the issues will be resolved by bankruptcy law. The Bankruptcy Court may enter a final order only in such core proceedings. Consequently, even if no jury demand were implicated, this court could only recommend an outcome to the District Court above. On the other hand, state Circuit Court has plenary jurisdiction, and the case can proceed from pretrial to jury verdict to judgment in one forum there

6. Prejudice to the involuntarily removed parties: Acceptance Loan, which initially chose the state court forum, now chooses a federal one. However, the Caffees made the Section 1452 option available by filing Chapter 13 bankruptcy while the case was pending in state court. Now, it is the Caffees who wish go back to state court for a decision. (Mrs. Caffee has been dismissed as a party to the original Chapter 13, but she is still her husband's codebtor on the loan, and has filed her own bankruptcy.) One way or another, the actions of both plaintiffs and defendant have brought this case to Bankruptcy Court.

7. Comity considerations: This "related-to" lawsuit involves no bankruptcy claims or issues; and a state court judge has already considered, and ruled on two pretrial motions. In such circumstances, federal courts should use restraint in retaining removed lawsuits.

8. Possibility of inconsistent results: Since there are many precedents in case law, on the federal statutes and state law involved, a widely inconsistent result is unlikely given the legal expertise of all three courts involved. However, it would be an more unwieldly to reach that result in the federal system, as well as requiring two more judges to familiarize themselves with the facts and the law from scratch.

It appears to this court that the equities in this particular case are due to be remanded to the Tuscaloosa County Circuit Court pursuant to 28 U.S.C. § 1452(b).

CONCLUSION

The court finds that the Caffees' motion to remand is due to be **GRANTED**; and the creditor's opposition is due to be **OVERRULED,** pursuant to 28 U.S.C. § 1452(b)**.** The court will enter an a separate order, consistent with these findings pursuant to Fed. R. Bankr. P. 7052.

DONE and ORDERED this July 8, 2005.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE: **BK 04-72563-CMS-13**

EARNEST LEE PALMER,

DEBTOR.

MEMORANDUM OF DECISION

This matter was set for hearing on confirmation of the debtor's (Earnest Lee Palmer's) amended Chapter 13 plan (BK Doc. 40); and on his motion to set aside this court's order denying a motion to value his home, and to avoid creditor Ervin Palmer's (creditor is also referred to as Irving Palmer in some documents provided to the court) judgment lien on the property.[1] The matter was also set for hearing on Ervin Palmer's motion to dismiss the bankruptcy case. (BK Doc. 39) The court finds that debtor's amended plan is due to be **CONFIRMED** and the creditor's motion to dismiss **DENIED.** The court further finds that the debtor's motion to set aside the order denying his motion to value and avoid lien is to be **GRANTED** and his motion to avoid the judgment lien of the creditor is due to be **GRANTED** pursuant to 11 U.S.C. §522(f).

FINDING OF FACTS

The court has deduced the following findings of fact from the Chapter 13 case file and from testimony at hearings which closed April 6, 2005. Testimony referred to various documents, including other court proceedings, but most were not offered as exhibits during the

[1] The debtor's previous motion to value and avoid lien had been denied after the debtor failed to appear at hearing.

trial.

A brief description of the relationship between the parties is as follows:

The debtor Earnest Lee Palmer is a minister at Cornerstone Full (Baptist or Gospel) Church in Tuscaloosa, Alabama. The debtor's sister, Freddie Mae Palmer, was killed in a vehicular accident in approximately December, 1991 or January, 1992. Freddie Mae Palmer was the mother of the objecting creditor, Ervin Palmer, the debtor's nephew.

Ophelia Palmer was the mother of debtor Earnest Lee Palmer and the late Freddie Mae Palmer, and grandmother of creditor Ervin Palmer. Ervin Palmer was living with his grandmother Ophelia Palmer in Birmingham when his mother was killed. In fact, creditor Ervin Palmer; and debtor Earnest Lee Palmer were reared in the same household. At some point following Freddie Mae Palmer's death, Ophelia Palmer's health declined and she moved to Tuscaloosa to live with Earnest Lee Palmer. Creditor Ervin Palmer also moved to Tuscaloosa and lived with the debtor and his wife for eight months.

Creditor's Exhibit 2 showed that the debtor was appointed administrator of his sister's estate. Additionally, Creditor's Exhibit 7 showed Ervin Palmer had granted a durable power of attorney to his uncle, Earnest L. Palmer. There is no copy of the power of attorney itself in the record, and no evidence that Ervin Palmer was not legally competent to handle his own business when he executed it.

The debtor, as administrator of his sister's estate, brought a wrongful death action based on the fatal accident. See Ala. Code § 6-5-410[2]. The suit produced a settlement netting

[2] **Ala. Code § 6-5-410** provides the following:

(a) A personal representative may commence an action and recover such damages as the

$71,481.88. (Creditor's Exhibit 6) It is undisputed that the debtor received the $71,481.88 wrongful death recovery.

In addition to the suit proceeds, it is also undisputed that, on January 30, 2002, the debtor received possession of an $11,697.52 State of Alabama Retirement System check payable directly to Ervin T. Palmer. Creditor's Exhibit 7 indicated that Ervin Palmer received the payment as a beneficiary.

These contested matters in bankruptcy reflect a continuing dispute between the debtor and his nephew about the debtor's use of the settlement and state retirement benefits.

Earnest Lee Palmer testified he spent all of the funds for Ervin Palmer's benefit. Ervin Palmer contended that he received no benefit from the money. It is undisputed that all the money was, indeed, spent.

Ervin Palmer initially testified that he received none of the approximate $83,180.00 held by his uncle, and received no benefit from its use. However, he later testified that he only received approximately $500.00 to $600.00 from his uncle. Evidence was that approximately

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> jury may assess in a court of competent jurisdiction within the State of Alabama, and not elsewhere, for the wrongful act, omission, or negligence of any person, persons, or corporation, his or their servants or agents, whereby the death of his testator or intestate was caused, provided the testator or intestate could have commenced an action for such wrongful act, omission, or negligence if it had not caused death.
>
> (b) Such action shall not abate by the death of the defendant, but may be revived against his personal representative and may be maintained though there has not been prosecution, conviction or acquittal of the defendant for the wrongful act, omission, or negligence.
>
> (c) <u>The damages recovered are not subject to the payment of the debts or liabilities of the testator or intestate, but must be distributed according to the statute of distributions.</u>
>
> (d) Such action must be commenced within two years from and after the death of the testator or intestate.(emphasis added)

$20,000.00 to $25,000.00 went to Bradford Treatment Center where Ervin Palmer was treated for alcohol abuse. Ervin Palmer denied that this was a proper use of his funds. Approximately $8,500.00 was also spent for the funeral expenses the creditor's mother, Freddie Mae Palmer. Ervin Palmer disputed the appropriateness of this use of his money, as well as for payment of other expenses for his late mother. The most questionable expenditure by Earnest Lee Palmer came for the care of Ophelia Palmer, the debtor's mother and the creditor's grandmother. Plaintiff's Exhibit 2 showed that expense to be either $8,700.00 or $11,100.00. (Exhibit 2 is unclear as to the total amount.) The debtor testified that while his mother, Ophelia Palmer; and his nephew were both living with Earnest Lee Palmer and his wife, personal conflicts arose in the household. The situation made it necessary for either Ophelia Palmer or Ervin Palmer to move out. Earnest Lee Palmer elected to move his mother to a nursing home, and to allow Ervin Palmer to continue living in his home. Ervin Palmer's funds were used for the nursing home expenses, and allegedly for other care for Ophelia Palmer. Ervin Palmer disputed the appropriateness of this choice and contended he had worked and paid rent while he lived in his uncle's home. The debtor Earnest Palmer denied that this was true.

Neither party's testimony specified whether the allegedly improper spending of funds arose under color of the debtor's power as administrator of the estate of Freddie Mae Palmer, or under the power of attorney granted by Ervin Palmer. Creditor's Exhibit 2 is the debtor's (as estate administrator's) report of settlement and a petition for a hearing on the report before the Jefferson County Probate Court. There is no copy in the record of any final order by the Probate Court after the request for a settlement hearing. The report noted receipt of the $71,481.88 wrongful death recovery. The report contained no listing for the retirement system check

which was directly payable to Ervin T. Palmer.

Ervin Palmer testified that the power of attorney he had granted to the debtor was revoked, but it is unclear when this occurred. Creditor's Exhibit 2 itemized disbursements by the administrator beginning January 14, 1992 and ending October 13, 1993. This report reflected the receipt of the $71,481.88, and detailed disbursements totaling $57,145.41. The administrator reported a zero balance in the estate as of the request for settlement hearing.

Testimony showed that the creditor subsequently sued the debtor in Jefferson County Circuit Court for what was described as a breach of fiduciary duties. However, there is no copy of the complaint in this record. Subsequently, a default judgment was entered against Earnest Lee Palmer. The record does not contain a copy of the judgment order in favor of Ervin Palmer and there was no evidence indicating whether or not the debtor had participated in the litigation process leading to the order.

The debtor filed his bankruptcy petition on August 19, 2004, including his original Chapter 13 Plan Summary. (Bk Doc. 2) In this first plan, the debtor proposed to pay unsecured creditors a total of $3,544.00. Earnest Lee Palmer listed the judgment debt to Ervin Palmer in his schedules.

That same day (August 19, 2004), Earnest Lee Palmer also filed a motion to avoid Ervin Palmer's judicial lien, and to value the debtor's residential real estate.[3] (Bk Doc. 5) The

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[3] Debtors typically file valuation motions under 11 U.S.C. § 506 to reduce the amount of secured debt a Chapter 13 plan must provide for. Section 506(a) states the following:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim

creditor filed Proof of Claim 3 in the amount of $264,104.21; and on September 19, 2004, an objection to the debtor's motion to avoid his judgment lien (Bk Doc. 16). By the claims bar date a total of approximately $697,649.00 in claims had been filed, which includes Ervin Palmer's $264,104.21 claim, and IRS claim of $239,400.00, and mortgage claims totaling $192,642.36.

After the first meeting of creditors, the debtor filed an amended plan on October 7, 2004 (Bk Doc. 18). The amended plan provided for the same $3,544.00 pro-rata distribution to unsecured creditors, but provided for Ameriquest Mortgage, first mortgagee on the debtor's residence, to be paid directly by the debtor. The hearing on the debtor's motion to value and to avoid the judicial lien, originally set for October 19, 2004, was continued to November 9, 2004, along with confirmation of the amended plan.

October 31, 2004, Ervin Palmer again objected to the debtor's motion to avoid his judicial lien and for valuation of the residence, filing exhibits on that day, and on November 4, 2004. (Bk Docs. 24, 25 and 26) Creditor's objection alleged that Earnest Lee Palmer had failed to disclose all of his assets, creditors, and income, as required by the Bankruptcy Code.

The confirmation hearing and motion to avoid lien and value real estate were continued from November 9, 2004 to December 21, 2004. November 15, 2004 the debtor filed an amendment to his schedules (Bk Doc. 28) adding the U.S. Internal Revenue Service (IRS) as a creditor. All matters were continued from the December 21, 2004 date to January 13, 2005.

> to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. ...

Under 11 U.S.C. § 541, the "estate's interest" is defined by the debtor's property interests as of the petition date. Secured claims are paid as a higher distribution priority in Chapter 13 than general unsecured claims. Unsecured creditors often receive only a small percentage of what they were owed.

The debtor failed to appear at the January 13, 2005 hearing. The court then entered an order denying confirmation of the Earnest Lee Palmer's plan and granting him until January 20, 2005 to file an amended plan. (Bk Doc. 35) In the absence of the debtor, the order also sustained Ervin Palmer's and the Chapter 13 trustee's objections to confirmation, and denied the debtor's motion to value and to avoid judicial lien.

January 19, 2005, the debtor filed his motion to set aside the court's order denying avoidance of the lien and valuation of the real estate. (Bk Doc. 37) That same date, the creditor filed a motion to dismiss the bankruptcy case, and to bar debtor from refiling another bankruptcy case. (Bk Doc. 39)

The next day, January 20, 2005, Earnest Lee Palmer filed his last amended plan. (Bk Doc. 40) Debtor's second amended plan proposed the same distribution to unsecured creditors as the first two plans. He again proposed to pay Ameriquest Mortgage directly on its first mortgage on his residence. The plan further proposed to pay R.D. Drake, who held the second mortgage on the residence, $1,451.12 in arrears through the plan, with the debtor to pay current payments directly. The debtor's plan also proposed to pay the IRS $78.04 per month on the priority portion of its tax claim.

All matters were set for hearing March 1, 2005; and were again continued to March 15, 2005. March 1, 2005 the debtor amended his Schedule J expenses. (Bk Doc. 47)

Testimony began in these matters March 15, 2005 and concluded April 6, 2005.

The debtor and his non-filing wife own their home in Tuscaloosa County, Alabama. The evidence was that tax authorities appraised it at $170,000, but that its current market value was $190,000.00. Ameriquest Mortgage's first mortgage had a payoff balance of $201,133.26,

while Drake's payoff balance on the second mortgage was $2,825.69. The debtor owns no other real estate individually.

The debtor is employed by Cornerstone Church and Cornerstone, Inc. The church, a nonprofit corporation, owns its building and the four acres it stands on. While the debtor is a guarantor on the mortgage, he owns no interest in the real estate. Debtor's Schedule B also listed various items of personal property, including stock in Earnest L. Palmer Ministries, Inc., another nonprofit corporation established by the debtor. There was no evidence of any value in this corporation and no evidence that the debtor has or will derive any income from this corporation.

A certain amount of testimony concerned a Rolls Royce automobile. The evidence was that this automobile is owned by Cornerstone, Inc., which paid approximately $25,000.00 for it three years ago. As minister at Cornerstone Baptist Church, the debtor once had the use of this vehicle; but, apparently, it has been in a repair shop since April 2004. There was no evidence showing that Earnest Lee Palmer had an ownership interest in the car as an individual.

The court took all these matters under submission for a decision after the close of evidence on April 6, 2005.

CONCLUSIONS OF LAW

This court has jurisdiction of Earnest Lee Palmer's Chapter 13 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of these contested matters, core bankruptcy proceedings arising under the Bankruptcy Code, pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court pursuant to 28 U.S.C. § 157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, As Amended July 17, 1984.

Ervin Palmer's motion to dismiss this Chapter 13 case, and other accusations of misconduct against his uncle, appear to be continued efforts to collect on a judgment debt entered in state court.

However, the underlying legal issue properly before this Bankruptcy Court is whether Earnest Lee Palmer's plan, as amended, is confirmable under the Bankruptcy Code. If the plan is not confirmable, the case is due to be dismissed and all bankruptcy issues are mooted. However, if the debtor has proposed a legally confirmable plan, the court must deny Ervin Palmer's motions, and confirm the plan.

That is a federal question under the Bankruptcy Code, albeit an extremely fact-sensitive one, fleshed out by state law. The court must ultimately determine whether the debtor's plan was proposed in "good faith" as required by 11 U.S.C. §1325(a)(3).

I.

The creditor's allegations seek to show that the plan has not been proposed in "good faith."

11 U.S.C. § 1325 sets out the requirements for confirmation of a Chapter 13 case. Based on the evidence and the record, the only plan requirement conceivably challenged by these objections is the "good faith" requirement of § 1325(a)(3).[4] It states:

(a) Except as provided in subsection (b), the court shall confirm a plan if–

> ... (3) the plan has been proposed in good faith and not by any means forbidden by law; ... (emphasis added)

[4] The debtor's documents and testimony at hearing show that all other § 1325(a) requirements have been met, including the liquidation test of § 1325(a)(4). The creditor offered no credible evidence to the contrary.

Ervin Palmer's allegations, or objections, have placed this issue before the court. § 1325(b)(1) provides that if an unsecured creditor objects to confirmation, the court "may not approve" the plan unless the objecting creditor is either paid the full amount of his claim (§ 1325(b)(1)(A)); or, alternatively:

> ... (B) the plan provides that all of the debtor's projected income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

Since the debtor does not propose to pay Ervin Palmer the full amount of his claim, Subsection 1325(b)(1)(B) applies. § 1325(b)(2) defines "disposable income" as income "not reasonably necessary" for living expenses.

The evidence was that the debtor has disclosed all of his income and the income of his non-filing wife. There was no evidence of any other income coming into the household. There was no evidence that the expenses in the amended Schedule J were incorrect or inflated. The debtor has proposed to pay all of his disposable income to the Chapter 13 trustee for a full 60 months, and there is no proof to the contrary. There is no evidence that the debtor owns any property, either real or personal, not revealed in his petition.

Consequently, the court finds that the plan must be confirmed unless the debtor's plan is not proposed in good faith in the meaning of § 1325(a)(3).

II.

The evidentiary record in this case does not reveal the kind of egregious bad conduct which would bar confirmation under Section 1325(a)(3).

The Eleventh Circuit Court of Appeals long ago provided a guide for the factual

examination a court must make to answer the legal "good faith" issue.

The framework was set out in the venerable Kitchens v. Georgia Railroad Bank and Trust Company (In re Kitchens), 702 F.2d 885, 88-89 (11th Cir. 1983). All of the "Kitchens factors" seek to isolate a pattern of conduct from which a court must deduce that a Chapter 13 petition was filed in bad faith. See also In re McGovern, 297 B.R. 650, 658 (S.D. Fla. 2003).

Whether or not this debt would be dischargeable in a Chapter 7 case is one of the "Kitchens factors" implicated in the Palmer case, but it is a circumstance courts have weighted heavily in the "good faith" analysis, particularly when an objection alleges fraud. The Eleventh Circuit court adopted this factor from a prior Eighth Circuit opinion:

> The Eighth Circuit court also added to the list (of factors) consideration of the type of debt to be discharged and whether such debt would be nondischargeable under chapter 7. In re Estus, 695 F.2d at 317. This point arose in the Eighth Circuit case because the debtors were seeking to discharge student loans which are not dischargeable under chapter 7, as well as loans from employee credit unions. This is yet another factor to which bankruptcy courts should be alert.

See Kitchens, 702 F.2d at 889.

Chapter 13 reorganization was designed by Congress to reward debtors who wished to repay at least part of their prepetition debt with a broader discharge than offered in Chapter 7 liquidation. The Chapter 13 "super discharge" has been whittled down by amendment since the Code was adopted in 1978, including making most student loan debts nondischargeable. See 11 U.S.C. § 1328(a)(2).

However, there is still a broader discharge for successful completion of a Chapter 13 plan, than following a Chapter 7 liquidation. Courts have considered the choice of Chapter 13 instead of Chapter 7 as an important indication of the debtor's state of mind or motives. Case law

shows it is particularly important when the objector is the sole or largest creditor listed, and the debt is a prepetition judgment debt for some species of fraud. See In re McGovern, 297 B.R. at 658-59; In re Goodwin, 2005 WL 1949632, * 2 (Bankr. M.D. Fla. 2005); In re Smith, 2005 WL 2030520, *4 (Bankr. W.D. Mo. 2005); and Handeen v. LeMaire (In re LeMaire), 898 F.2d 1346 (8th Cir. 1990).

A. The state court order does not preclude this court from considering the nondischargeability issue.

For example, debts created by acts of common law fraud under 11 U.S.C. § 523(a)(2); and by actions constituting " ...defalcation while acting in a fiduciary capacity" under § 523(a)(4) may still be discharged in Chapter 13, but are nondischargeable in Chapter 7. Irvin Palmer has, at the very least, accused his uncle of misuse of his funds, and described the default judgment as being for breach of fiduciary duty. However, he has offered no objective proof that this is true, beyond the bare default order entered by the state circuit court.

A default order is not automatically determinative of dischargeability in Bankruptcy Court. Neither Alabama nor federal rules of collateral estoppel would bar this court from considering the nature of the debt. In both fora, the issues must have been actually litigated between the parties before preclusion may apply. See Bush v. Balfour Beatty Bahamas, Limited (In re Bush), 62 F.3d 1319, 1323 (11th Cir. 1995); and Angus v. Wald (In re Wald) 208 B.R. 516, 529 (Bankr. N.D. Ala. 1997) (citing to Lott v. Toomey, 477 So.2d 316, 319 (Ala. 1985); Crowder v. Red Mountain Mining Co., 127 Ala. 254, 29 So. 847 (1900); and Barnett v. Pinkston, 238 Ala. 327, 191 So. 371 (1939)). So this court must analyze these transactions for "good faith" solely on the Bankruptcy Court record.

Both the § 523(a)(2) discharge exception for fraud; and the § 523(a)(4) exception for fiduciary fraud require a high degree of proof, even in Chapter 7.

B. The debtor was not acting in a "fiduciary capacity" when he used Ervin Palmer's funds.

Here, the debtor's dual capacity as estate administrator for Freddie Mae Palmer, and as holder of a power of attorney for Ervin Palmer has confused issues for both parties.

A successful nondischargeability action under § 523(a)(4) requires proof of both fraud or defalcation and that the debtor committed the fraud or defalcation while in a fiduciary capacity. The narrow definition of "fiduciary capacity" required by § 523(a)(4) presents a high hurdle for the objecting creditor. Courts have required that the disputed transaction be part of an "express," rather than equitable, trust, under the law of the forum state. See Quaif v. Johnson, 4 F.3d 950, 953 (11th Cir. 1993); Dominie v. Jones (In re Jones), 306 B.R. 352, 355 (Bankr. N.D. Ala. 2004); and Cardile Bros. Mushroom Pkg, Inc. v. McCue (In re McCue), 324 B.R. 389, 392 (Bankr. M.D. Fla. 2005). As stated in Houston v. Capps (In re Capps), 193 B.R. 955, 961 (Bankr. N.D. Ala. 1995):

> Generally speaking, "a trust is a confidence reposed in one person, by and for the benefit of another, with respect to property held by the former, for that other's benefit. Gordon v. Central Park Little Boys League, 270 Ala. 311, 316, 119 So. 2d 23, 27 (1960). The person in whom the confidence is reposed and who holds the title to the property is the trustee; and the person for whose benefit the property is so held by the trustee is the cestui que trust. Id.
>
> An express trust is created by the direct and positive act of a party. Phillips v. Phillips, 223 Ala. 475, 477, 136 So. 785 (Ala. 1931) It arises as a result of a manifestation of intention to create the trust relationship. Austin W. Scott, Abridgment of the Law of Trusts § 2.8 (1960). No express words are necessary if the intention to create the relationship is otherwise manifested. Gordon v. Central Park Little Boys League, 270 Ala. at 316, 119 So. 2d at 27. The intention to create the relationship may be inferred from the facts and circumstances of a particular case. Id. "An express trust may be created even though the parties do not call it a trust, and even though they do not

understand precisely what a trust is; it is sufficient if what they appear to have in mind is in its essentials what the courts mean when they speak of a trust." Scott, supra, at 26.

The court's analysis of the Palmer facts indicates that Ervin Palmer has failed to prove that Earnest Lee Palmer's disputed use of the creditor's funds occurred when the debtor was "acting in a fiduciary capacity."

The creditor's arguments did not specify whether the alleged misconduct occurred in the debtor's capacity as administrator of Freddie Mae Palmer's estate; or in use of the durable power of attorney Ervin Palmer granted. An administrator would have fiduciary duties to distribute property of a decedent's estate to beneficiaries as required by state law. Diversion of estate property from those beneficiaries under the law would comprise fiduciary misconduct under both bankruptcy and Alabama law because the legal relationship does comprise an express trust.

However, the disputed payments (the wrongful death settlement and the state retirement check) in this case were never property of the decedent's estate. Both payments were the direct property of the creditor, Ervin Palmer; rather than property of the estate of Freddie Mae Palmer.

Under Alabama's wrongful death statute, Ala. Code 6-5-410(c), a damage award is exempt from the debts and liabilities of the estate, and passes directly to beneficiaries. The same is true of the check to Ervin Palmer from the Retirement Systems. It was made out directly to Ervin T. Palmer, not to the Estate of Freddie Mae Palmer.

The only official capacity in which the debtor could receive and spend the funds was under the power of attorney. Under Alabama law, exercise of a durable power of attorney does not automatically create a fiduciary duty to the grantee. Longstanding case law has generally construed the relationship as one of agency.

When the grantor is legally competent to manage his own affairs, the relationship is one of agency only – the agent acts under the legal fiction that he is the grantor, not as a trustee for a beneficiary of the grantor. See Lamb v. Scott, 643 So. 2d 972, 974 (Ala. 1994). Alabama common law requires the person exercising a power of attorney do so for the benefit of the grantor and not to service his own individual interest; and that use of the agency granted in the power of attorney not exceed those "expressly conferred".

As stated in Seeberg v. Norville, 204 Ala. 20, 85 So. 505 (Ala. 1920):

> It is the unquestionable duty of an agent to act in matters touching the agency with due regard to the interest of his principal. In accepting the agency, he impliedly undertakes to give his principal his best care and judgment, and to use the power conferred upon him for the sole benefit of his principal consistent with the purpose of the agency.

State courts have, at times, inferred a breach of a legal duty in egregious self-serving transactions exceeding the express powers granted by the power of attorney. In those cases, the overall factual circumstances of the conduct have constituted a breach of an "express trust" sufficient to void the transaction. See Seeberg v. Norville, 204 Ala. 20, 85 So. 505, (Ala. 1920); Lamb v. Scott, 643 So. 2d at 973-74; and Barron v. Scroggins, 2005 WL 736748 (Ala. Civ. App. 2005). See also Johnson v. Thompson (In re Thompson), 234 B.R. 820, 822 (Bankr. M.D. Ala. 1998), (court deduced Section 523(4)(a) nondischargeability where factual circumstances created an "express trust") and Dominie v. Jones (In re Jones), 306 B.R. 352 (Bankr. N.D. Ala. 2004) (court could not deduce a Section 523(a)(4) "express trust" from facts).

Ervin Palmer has failed to establish what powers the durable power of attorney "expressly conferred" on Earnest Lee Palmer since no copy nor any testimony stated the terms to the court. It is undisputed that the debtor did use the money, presumably under the durable power of

attorney, but the record facts do not indicate misuse of his agency, much less conduct reaching the level of fiduciary fraud under §523(a)(4). The obligation could not be excepted from discharge in Chapter 7 under §523(a)(4).

C. Ervin Palmer has failed to show the judgment debt was created by a fraudulent transaction in the meaning of §523(a)(2).

In the Eleventh Circuit, courts have generally held that creditors objecting under §523(a)(2) must prove the elements of common law fraud by a preponderance of the evidence. Those elements include evidence that the debtor made a false representation in order to deceive the creditor, that the creditor justifiably relied on the falsehood, and that the creditor suffered damages as a result of the fraud. See Securities and Exchange Commission v. Bilzerian (In re Bilzerian), 153 F.3d 1278, 1281-82 (11th Cir. 1998).

First, it is not clear from the evidence exactly what Ervin Palmer alleges Earnest Lee Palmer's misrepresentation to be. Second, the record contains no direct evidence proving, or circumstantial evidence from which a court could deduce, the debtor's intent to defraud in any representation. Consequently, the Ervin Palmer case, as presented, could not win a §523(a)(2) action in Chapter 7.

Consequently, the court cannot deduce from this record that the judgment debt Ervin Palmer holds against the debtor Earnest Lee Palmer was due to fraudulent conduct on the debtor's part, much less fraudulent conduct in the course of a fiduciary relationship.
Based on this record, the debt would be a dischargeable debt in both Chapter 13 and Chapter 7.

The court cannot deduce bad faith from the debtor's choice of a Chapter 13 reorganization over a Chapter 7 liquidation since creditor Ervin Palmer's situation is no worse in Chapter 13

than it would be in Chapter 7.

Since there is no evidence rebutting the plan's assertion that it complies with §1325(a), including §1325(a)(3), the plan must be confirmed.

CONCLUSION

Since Earnest Lee Palmer's proposed Chapter 13 plan meets all the requirements for confirmation under the Bankruptcy Code, the court must **CONFIRM** the plan as proposed. Creditor Ervin Palmer's motion to dismiss the bankruptcy case is **DENIED** and his objection to the confirmation of the plan is **OVERRULED**.

The undisputed evidence shows that the value of the debtor Earnest Lee Palmer's home is $190,000.00 and further that it is subject to a first mortgage in the approximate amount of $201,133.00 and a second mortgage in the approximate amount of $2,825.00, and therefore there is no equity to which the judgment lien of Ervin Palmer can attach. The debtor's motion to avoid this lien is therefore due to be **GRANTED** pursuant to 11 U.S.C. §522(f)(1)(A).

The court will enter a separate order consistent with these findings pursuant to Fed. R. Bankr. P. 7052.

DONE and ORDERED this September 16, 2005.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
WESTERN DIVISION

IN RE:

BK 04-70681-CMS-7

ROBERT DEAN PRUITT,

DEBTOR.

AP 04-70047-CMS

JACK KEY, and
RITA KEY,

PLAINTIFFS,

vs.

ROBERT DEAN PRUITT,
a/k/a Roofing & Sheet Metal, Inc. Pruitt, and
a/k/a Roofing & Sheet Metal Unincorp Pruitt;

DEFENDANT.

MEMORANDUM OF DECISION

This matter came before the court for trial on plaintiffs Jack and Rita Keys' complaint seeking to have damages owed by debtor Robert Dean Pruitt declared nondischargeable pursuant to 11 U.S.C. § 523(a)(2). The court finds that judgment must be entered **IN FAVOR OF THE KEYS** and **AGAINST PRUITT.**

FINDING OF FACTS

The court heard the testimony of the plaintiff/creditor Jack Key and of the defendant/debtor Robert Dean Pruitt at a trial held September 8, 2005. The facts in evidence indicate the following:

Jack and Rita Key planned to do some remodeling on their home in early 2003. The job was to entail adding a room, reroofing the house, and covering its exterior with vinyl siding. The Keys

solicited bids and received estimates ranging from a high of approximately $38,000.00 to debtor Robert Dean Pruitt's low bid of $15,500.00. The Keys accepted Pruitt's low bid, and on March 22, 2003 entered into a written agreement with the debtor, doing business as Pruitt Roofing and Sheet Metal, for the $15,500.00 agreed price.

Key testified that he met with Pruitt at his home where Pruitt represented to him that he was a licensed and insured homebuilder. The debtor began the remodeling job. Testimony was in dispute as to the exact extent Pruitt completed the work. However, at a minimum, the foundation was completed, the room addition was framed, and a new roof was placed on the house before Pruitt left the job.

During construction, a state inspector came to the job site and ordered Pruitt to discontinue work. Pruitt had a roofing license, but did not have a license for homebuilding as required for projects in excess of $10,000.00.

Pruitt testified that the project was to consist of three parts – one-third roofing, to be done by him; one-third carpentry , to be done by Tim Rainer; and one-third vinyl siding, to be done by Ed Jordan. Pruitt referred to this as a joint venture with Rainer and Jordan. He stated that the $15,500.00 estimate was really a total of three separate costs for the three parts of the work. However, only one contract was entered into.

Apparently, this explanation did not satisfy the under-$10,000.00 exception for requirement of a homebuilding license. Pruitt testified that he had not finished reroofing the Key house at the time of the stop order. He said he advised the state inspector that he intended to complete the roof in order to protect Keys' property. He stated that he finished the roof over the weekend despite the stop order.

The Keys had paid Pruitt $10,500.00 prior to the stop order. Other than the roof, the work had not been completed, and the Keys hired the debtor's carpenter, Tim Rainer, to finish the job. Key testified that it cost him an additional $20,000.00 to complete the remodeling.

Pruitt testified that prior to the stop order he had paid $2,000.00 for the roofing materials, plus $3,600.00 for other construction materials. In addition, he had already paid Tim Rainer $2,000.00 for carpentry; and paid $2,500.00 to Hank Tomlin for roofing work. These payments accounted for a total of $10,100.00 of the $10,500.00 he received before the stop order.

Pruitt also testified he could not have completed the job for the $15,500.00 he bid, but that he would have finished it at a loss if the state inspector had not stopped him. Subsequent to these events, Pruitt was charged with what appears to have been doing business without a license, pleaded guilty to a misdemeanor, and was assessed a $2,000.00 fine.

Pruitt filed a Chapter 7 bankruptcy petition on March 9, 2004. On June 10, 2004, the Keys filed this lawsuit seeking have their claim against Pruitt held nondischargeable as obtained by fraud in the meaning of 11 U.S.C. § 523(a)(2)(A).

CONCLUSIONS OF LAW

This court has jurisdiction of Robert Dean Pruitt's Chapter 7 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this lawsuit, a core bankruptcy proceeding arising under the Bankruptcy Code, pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court pursuant to 28 U.S.C. § 157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, As Amended July 17, 1984.

I.

A creditor must prove the elements of common law fraud

to establish Section 523(a)(2)(A) nondischargeability.

Section 523(a)(2)(A) excepts debts created by a fraudulent representation from the discharge available under Chapter 7 of the Bankruptcy Code.

Federal courts have generally held that creditors objecting to discharge under 11 U.S.C. § 523(a)(2)(A) must prove the elements of common law fraud by a preponderance of the evidence. Those elements include evidence that the debtor made a false representation in order to deceive the creditor, that the creditor justifiably relied on the falsehood, and that the false representation was the proximate cause of damages to the creditor. See Field v. Mans, 516 U.S. 59, 70-71 (1995); Securities and Exchange Commission v. Bilzerian (In re Bilzerian), 153 F.3d 1278, 1281-82 (11th Cir. 1998); and Pleasants v. Kendrick (In re Pleasants) 219 F.3d 372 (4th Cir. 2000) (which is factually similar to Pruitt).

These facts must be judged under Section 523(a)(2)(A) since the primary false representation alleged was made orally, and not in writing as under Section 523(a)(2)(B).

Section 523(a)(2)(A) reads as follows:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt --
>
> > (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by –
> >
> > > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; ...

Courts must require proof of all elements by a preponderance of the evidence to hold a debt nondischargeable under Section 523(a)(2)(A). See Grogan v. Garner, 498 U.S. 279, 291 (1991). Elements of the required common law fraud case, can be , and usually are, deduced by the court from

all the circumstances on a case-by-case basis. In some cases, an intentional omission or failure to disclose material information can constitute the misrepresentation as required by Section 523 (a)(2)(A). See Peterson v. Bozzano (In re Bozzano), 173 B.R. 990, 993 (Bankr. M.D. N.C. 1994); and Hanft v. Church (In re Hanft), 315 B.R. 617 (S.D. Fla. 2002), aff'd Hanft v. Church, 73 Fed.Appx. 387 (11th Cir. 2003), (table listing). Likewise the debtor's intent to deceive and the creditor's justifiable reliance, is usually shown with "all the circumstances" evidence. Additionally, the creditor must identify damages flowing from the debtor's fraudulent representation.

II.

The Keys have proved that their damage claim should be nondischargeable under 11 U.S.C. § 523(a)(2)(A).

Construction disputes have been a fairly frequent source of Section 523(a)(2)(A) complaints in bankruptcy cases. They have often centered on a contractor's workmanship, or the lack of workmanship, which allegedly damaged the creditor. Sometimes the question has turned on a representation about a required license, as in this case.

For example, in Gem Ravioli, Inc. v. Creta (In re Creta), 271 B.R. 214 (1st Cir. BAP 2002), the contractor Creta was found to have represented that he was licensed by the State of Rhode Island to perform refrigeration and air-conditioning work. The creditor, Gem Ravioli, Inc., hired Creta and paid him to install two air-conditioning units. Creta was not licensed and shortly after installation both units failed. After Creta filed Chapter 7 bankruptcy, Gem Ravioli sued to have its $7,053.78 state court damage judgment against him held nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A).

The First Circuit Bankruptcy Appellate Panel held, on appeal[1], that Creta's misrepresentation

[1] The Rhode Island Bankruptcy Court ruled in favor of the debtor, construing Section 523(a)(2)(A) to require the creditor to prove both that Creta knew his statement that he was

of his status induced the contract and "deprived Gem Ravioli of the opportunity to contract with a qualified refrigeration technician." The court stated:

> It is clear that the Rhode Island licensing requirements for licensing refrigeration technicians is not simply a registration or revenue raising scheme, but rather the statute was enacted to ensure a certain level of competency by refrigeration technicians.
>
> Thus, when an individual asserts that he possesses a refrigeration license, whether it be an apprentice's license, a journeyperson's license, or a master's license, he is making a representation that he possesses the necessary level of skill and knowledge to perform refrigeration and air conditioning work. A misrepresentation as to whether a debtor has such a license goes to the very essence of the agreement, i.e., the reliance of the contracting party that the debtor has the requisite knowledge, experience, and training to properly complete the work. (emphasis added)

Creta, 271 B.R. at 220.

The panel held that Gem Ravioli met its initial burden of showing that Creta's misrepresentation resulted in the damage, and that the debtor failed to rebut that prima facie case by producing evidence of subsequent intervening causes for the damages. The panel found that the $7,053.78 judgment debt was nondischargeable pursuant to Section 523(a)(2)(A).

In Pleasants v. Kendrick (In re Pleasants), 219 F.3d 372 (4th Cir. 2000), the Fourth Circuit had also held that a remodeling contractor's representation that he was a licensed architect was the proximate cause of the creditor/homeowner's harm (having to pay third parties to correct and finish the job), and made the debtor liable for all such costs. The Fourth Circuit held that the homeowner's $1,262,296.00 in damage was nondischargeable under Section 523(a)(2)(A).

Morlang v. Cox, 222 B.R. 83 (W.D. Va. 1998) also involved the expenses/damages a

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licensed was false and that he knew that his work under the contract would be defective, when he made the statement. The First Circuit BAP reversed the Bankruptcy Court, holding that the debtor's knowledge that he was not licensed alone satisfied the intentional false statement requirement.

homeowner incurred to correct and finish a residential addition started by a contractor who falsely stated he was properly licensed. Morlang, the creditor, showed that the debtor, Cox, had falsely represented to her that "he had a Roanoke County business license which permitted him to legally perform the contracting work without a contractor's license."

Morlang entered a $9,000.00 contract for the work October 24, 1994. On March 22, 1995, Cox walked off the job, claiming that he had already incurred. $9,655.43 in costs on the unfinished work.

The creditor obtained a $7,179.00 state court judgment, plus interest, for breach of contract. Additionally, Cox was convicted of contracting without a state license under Virginia law. The debtor subsequently filed a no-asset Chapter 7. The District Court relied on Cohen v. De La Cruz, 523 U.S. 213 (1998) to hold that all of Morlang's subsequent completion costs were nondischargeable against Cox under Section 523(a)(2)(A). See the factually similar Peterson v. Bozanno (In re Bozzano), 173 B.R. 990 (Bankr. M.D. N.C. 1994) which was indirectly abrogated on other grounds by the 1998 Cohen decision. The North Carolina Bankruptcy Court had held that all Peterson's repair/completion costs were nondischargeable in Bozzano's bankruptcy – but not the full amount of treble damages which would have been allowed under North Carolina law. See also Sinha v. Clark (In re Clark), 2005 WL 2456246, (Bankr. C.D. Ill. 2005).

In Cohen, the Supreme Court held that a Chapter 7 debtor's obligation for the triple damages claimed under the New Jersey Fraud Act comprised the nondischargeable debt under Section 523(a)(2)(A). The court held that it was not Congress' intent to limit damages to funds the creditor had actually paid the debtor. The Court stated:

> ... [I]f, as petitioner would have it, the fraud exception only barred discharge of the value of any money or property, etc., fraudulently obtained by the debtor, the objective of ensuring full recovery by the creditor would be ill served. Limiting the exception to the value of the money

> or property fraudulently obtained by the debtor could prevent even a compensatory recovery for losses occasioned by fraud. For instance, if a debtor fraudulently represents that he will use a certain grade of shingles to roof a house and is paid accordingly, the cost of repairing any resulting water damage to the house could far exceed the payment to the debtor to install the shingles. ... As petitioner acknowledges, his gloss on § 523(a)(2)(A) would allow the debtor in those situations to discharge any liability for losses caused by his fraud in excess of the amount he initially received, leaving the creditor far short of being made whole.

Cohen, 523 U.S. at 222.

In the Key/Pruitt case now before this court, the evidentiary record is scanty on both sides. It is almost completely limited to the hearing testimony of Key, the plaintiff; and Pruitt, the defendant. However, both parties rested their cases based on this record and these are the only evidentiary facts the court has under submission for decision .

Key testified that Pruitt specifically stated to him in a conversation at his house that Pruitt was a licensed and insured homebuilder. Pruitt offered only vague assertions in response to the testimony, and never specifically denied that he made the statement. The creditor and the debtor then entered a single $15,500.00 remodeling contract based on the conversation.

Subsequently, both sides acknowledge that the State of Alabama stopped the job because Pruitt was not properly licensed to go forward. It is undisputed and material that Pruitt's failure to have a license resulted in his failure to complete the job, making the misrepresentation the proximate cause of what came after. Further, Pruitt did not deny in any way that the Keys spent still another $20,000.00 to complete the remodeling after he was forced to stop work.

To sum up: the record shows that Pruitt represented to Key that he was properly licensed to handle the remodeling job; that Pruitt was not licensed as a homebuilder for jobs of more than $10,000.00; that the Keys justifiably relied on the false representation and contracted with Pruitt to do the job for $15,500.00; that a state license inspector ordered Pruitt to stop the job and that he was

later fined $2,000.00 for performing unlicensed work; that his misrepresented license status shut down the job; and that the Keys had spent a total $35,500.00 by completion, $20,000.00 of it after the stop order.

Consequently, the court must find that the plaintiff met his burden of showing Section 523(a)(2)(A) fraud by a preponderance of the evidence in the record. The court finds that the creditor's $20,000.00 in additional completion cost is nondischargeable in Chapter 7 because it resulted from a false representation.

CONCLUSION

Judgment is due to be entered **IN FAVOR OF THE PLAINTIFF**, and **AGAINST THE DEFENDANT** in this lawsuit. An order, consistent with these findings pursuant to Fed. R. Bankr. P. 7052, will be entered separately.

DONE and ORDERED this October 27, 2005.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
WESTERN DIVISION

IN RE: JERRY MARION MORRISON, and JAN L. MORRISON, **BK 05-71078-CMS-7**

DEBTORS.

MEMORANDUM OF DECISION

This matter came before the court on creditor Fidelity & Deposit Company of Maryland's motion to extend the period for filing a nondischargeability action under 11 U.S.C. § 523 to allow a suit against debtors Jerry Marion Morrison and Jan L. Morrison. The court must decline to extend the deadline and the motion must be **DENIED.**

FINDINGS OF FACT

Debtors Jerry and Jan Morrison filed their Chapter 7 bankruptcy petition on April 12, 2005. No schedules were filed with the petition, only a matrix listing creditors' names and addresses. Fidelity & Deposit Company of Maryland (F&D) with an address listed as 1050 Crown Pointe Parkway, Atlanta, Georgia, 30338, was included on the matrix. At the time of the bankruptcy, a civil action filed by F&D against the Morrisons was already pending in the United States District Court for the Northern District of Alabama. The complaint stemmed from surety bonds F&D had issued on a construction job upon which the debtor and his company had defaulted.

The Morrisons' meeting of creditors pursuant to 11 U.S.C. § 341 was originally set for May 12, 2005. The 341 notice which was sent to listed creditors also stated that the last day for objecting to the debtors' discharge or to the dischargeability of any debts was July 11, 2005. On April 27, 2005, F&D's notice of the filing of the petition and of deadlines for filing complaints was returned to the Bankruptcy Clerk's Office. (Bk Doc. 20). The day before, April 26, 2005, the debtors had

filed their schedules. (BK Doc. 18) F&D later stipulated that its attorneys had notice of the bankruptcy filing as of April 26, 2005 when the debtors filed a suggestion of bankruptcy in the District Court action.

On May 31, 2005, attorney Ryan K. Cochran filed a Notice of Appearance and Request for Notice on F&D's behalf in the bankruptcy case. (Bk Doc. 31) The parties also stipulated that an attorney representing F&D had attended the June 2, 2005 first meeting of creditors. Bankruptcy Document 59 reflects that F&D requested copies of the 341 meeting tape recordings, and that the tapes were mailed June 8, 2005. On July 14, 2005, the transcriber signed an affidavit authenticating the transcription she had prepared.

The July 11, 2005 deadline for nondischargeability action passed with no objections/lawsuits or motions to extend filed. Then, on July 12, 2005, one day after the time period lapsed, F&D filed the motion to extend the deadline which is before the court. (BK Doc. 51, as amended by BK Doc. 105 on October 20, 2005) On that same day, July 12, 2005, the creditor also filed its nondischargeability complaint. (AP 05-70031 Doc. 1.)

July 27, 2005, F&D filed a motion to dismiss the Morrisons' Chapter 7 case or to convert it to a Chapter 11 reorganization. It further requested relief from the automatic stay in order to liquidate its claim against the debtors in the District Court action. This particular memorandum/order does not concern those issues.

F&D, in its motion to extend time to file a complaint, asserted that it had been diligent in attempting to determine whether or not it had a grounds to object to the dischargeability of the indebtedness, and that the debtor would not be prejudiced by a one-day extension. F&D appeared to assert that the time required to obtain a transcription of the 341 meeting justified a post-July 11, 2005 motion to extend deadline, retroactively validating the untimely filed complaint. The court

heard the evidence and the argument of the parties on this motion (BK Doc. 108) at an October 26, 2005 hearing; and took this, and other issues, under submission for decision.

CONCLUSIONS OF LAW

This court has jurisdiction of the Morrisons' Chapter 7 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this contested matter, a core proceeding arising under 11 U.S.C. § 523 and Fed. R. Bankr. P. 4007(c), pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court, pursuant to 28 U.S.C. § 157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, as Amended July 17, 1984.

I.

Generally, there are two schools of legal thought on the issue of whether the court may extend the deadline set by Fed. R. Bankr. P. 4007(c)

Bankruptcy Rule 4007(c) provides the following:

> A complaint to determine the dischargeability of a debt under § 523(c) shall be filed no later than 60 days after the first date set for the meeting of creditors under § 341(a). ... On motion of a party in interest, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be filed before the time has expired. (emphasis added)

F&D has asserted that the bankruptcy court, as a court of equity, can extend the deadline even on motion filed after the time has expired. It contends a one-day extension would not prejudice the Morrisons' interest. In the Eleventh Circuit, however, longstanding law would indicate otherwise.

Two Eleventh Circuit cases are very similar to the facts in this one. In Byrd v. Alton (In re Alton), 837 F.2d 457 (11th Cir. 1988) a creditor's complaint against the debtor was also pending in U.S. District Court when the debtors filed bankruptcy. (Alton involved a Chapter 11 bankruptcy.) The debtor did not list the creditor in his schedules; therefore, the bankruptcy court sent no notice to the creditor. In the Morrison bankruptcy, the original notice was returned to the court since the

address listed was incorrect. As in this case, the debtor in Alton sent the creditor a notice that he had filed bankruptcy approximately two weeks after the filing. The creditor acknowledged that this notice was received. However, the creditor did not receive the formal written notice of the bar date for filing complaints until several weeks after the deadline passed. He then filed an application to extend the time to file a complaint.

One of the grounds the creditor asserted for extension was that the debtor had caused him to miss the deadline; and, therefore, equity demanded an extension of the time to file a complaint. The Eleventh Circuit rejected this argument stating:

> At the outset, we reject Byrd's equities argument. It is true that there are some disturbing aspects to this case. We are particularly troubled that debtor Alton did not include appellant Byrd on the list of creditors made out pursuant to 11 U.S.C. sec. 521 and filed with his bankruptcy petition; and yet, some three weeks later, debtor Alton, through his attorneys, sent Byrd notice of the petition for a Chapter 11 reorganization and notice of the automatic stay. Thus, debtor Alton, by his own actions, first deprived creditor Byrd of official notice at various stages of the proceedings pursuant to the Bankruptcy Code by omitting Byrd from the creditor list; and Alton then put Byrd on actual notice that a proceeding was pending by mailing the notice of the proceeding and of the stay.
>
> The actual notice deprived Byrd of making any later claim of nondischargeability of this claim on the ground of lack of knowledge. ...
>
> Appellant emphasizes these harsh facts. "We agree that this is a hard case, but we cannot agree that it should be allowed to make bad law." FCC v. Woko, Inc., 329 U.S. 223, 229, 67 S.Ct. 213, 216, 91 L.Ed. 204 (1946) (Jackson, J.). Despite the misleading actions, inadvertent or intentional, of debtor Alton, the time specifications set out in the Bankruptcy Code are sufficiently clear to have placed an obligation on creditor Byrd to follow the case and to take the timely action necessary to pursue his claim. ... Appellants equities argument is thus rejected.
>
> Appellant's interpretation of the Bankruptcy Code and Rules is also unavailing. The dictates of the Code and Rules are clear. It is not our place to change them. Under Rule 4007(c), any motion to extend the time period for filing a dischargeability complaint must be made before the running of that period. There is "almost

> universal agreement that the provisions of F.R.B.R. 4007(c) are mandatory and do not allow the Court any discretion to grant a late filed motion to extend time to file a dischargeability complaint." See In re Maher, 51 B.R. 848, 852 (Bankr. N.D. Iowa 1985)(and cases cited therein).

Alton, 837 F.2d at 458-59.

In Durham Ritz, Inc. v. Williamson (In re Williamson), 15 F.3d 1037 (11th Cir. 1994), the creditor received a notice of the Chapter 11 bankruptcy petition, but the notice incorrectly stated that the deadline for filing complaint was "to be set." No further notice was sent. The deadline under Fed. R. Bankr. P. 4007(c) was 60 days after the first day set for the meeting of creditors.

One of the grounds asserted by the creditor was that equity demanded that the court allow the late complaint to be heard on its merits. The Eleventh Circuit nevertheless held that:

> The equities in this case do not justify the disregard of the time provisions in the Bankruptcy Code. "[T]he time specifications set out in the Bankruptcy Code are sufficiently clear to have placed an obligation on creditor [Durham] to follow the case and to take the timely action necessary to pursue [its] claim." Id. At 459. The difference between no notice from the clerk and the "to be set" notice in this case does not justify different treatment. In both cases the creditor was on actual notice of the pending action. Durham could have protected itself by simply filing within the sixty day period set forth in Rule 4007. It was Durham's inaction and not any action by ... (the debtor) or the court that caused the filing to be late. Any harm to Durham could have been avoided by simply following Rule 4007.

That has been the traditional, and strict, construction of the code and the rules in this circuit.

Both the Alton and the Williamson cases were decided by the Eleventh Circuit prior to the United States Supreme Court's Kontrick v. Ryan, 540 U.S. 443 (2004). The Kontrick case, however, was in a very different procedural posture than the Morrison case.

In Kontrick, the creditor's original dischargeability complaint had been filed within the Rule 4007(c) deadline. Later, after the allowed time period for objections had run, the creditor amended the original complaint to add a new count. The debtor answered the amended complaint and did not raise the untimeliness of the amendment, which alleged new grounds for denial of a discharge under

Section 727. After the trial court had awarded the creditor a summary judgment on the amended count, the debtor raised the timeliness issue and asserted that the court had no subject matter jurisdiction over the amended count since it was not filed within the allowed time.

The Supreme Court noted the split in the circuits on the question of whether or not Rule 4004 deadlines were jurisdictional or nonjurisdictional, and noted that the Eleventh Circuit was one of those circuits holding that timeliness was jurisdictional.

The Supreme Court in Kontrick held that Rule 4004 deadline for Section 727 actions is not jurisdictional; and, therefore, is waivable in a way that jurisdictional deadlines would not be. The debtor in Kontrick had failed to raise the issue in a timely manner, the court reasoned, and the defense had been waived.

However, the Kontrick court did not decide whether or not courts have the discretion to allow late complaints on equitable grounds. The court pointed out that lower courts are divided on this question, and noted that the Eleventh Circuit's Alton case had held Rule 4007(c) conferred no discretion to grant untimely motions to extend time to object. See Kontrick, 540 U.S. at 458.

The Kontrick court noted that the creditor had not claimed there were any equitable grounds for enlarging or extending the deadline for filing complaints, and the question of the court's equitable discretion was not presented. The court went on to state that it assumed, if the debtor had timely objected to the amended complaint, he would have prevailed on the issue. The Supreme Court did point out the relationship between Bankruptcy Rules 9006(b)(3) and Rule 4004. The Supreme Court noted that Rule 4004 applying to objections to debtor's discharge and Rule 4007 relating to the determination of the dischargeability of a debt (the issue in the Morrison case) are essentially the same and that Rule 9006 lists both among the time prescriptions that the bankruptcy courts may enlarge "only to the extent and under the conditions stated in the rules themselves".

Rule 4007(c) states that an objection or a motion to extend the deadline for objecting to discharge of a debt must be filed within the 60 days after the first date set for the meeting of creditors. The rule clearly specifies that "The motion shall be filed before the time has expired". Rule 9006(b)(3) provides "The court may enlarge the time for taking action under Rules ... 4007(c) ... only to the extent and under the conditions stated in those rules."

The debate still continues in the lower courts. Some courts have interpreted this language to mean that there are no equitable grounds allowing extension of the Rule 4007(c) deadline. See Francis v. Eaton (In re Eaton), 327 B.R. 79, 85 (Bankr. D. N.H. 2005) (interpreting Kontrick).

The Sixth Circuit has held otherwise. In the case of Nardei v. Maughan (In re Maughan), 340 F.3d 337 (6th Cir. 2003), the court held that the limitation set out in Rule 9006 must be read together with the general powers granted bankruptcy courts in 11 U.S.C. § 105. It reasoned that a bankruptcy court using its Section 105 powers can allow the late filing of a dischargeability complaint if required by the equities.

II.

The facts in this case do not justify extension under either school of legal thought.

This court will not address the issues of whether it can use its equitable powers to extend the Rule 4007(c) deadline when the motion to extend is not filed until after the deadline has already run. It is not necessary to do so to resolve this contested matter.

Assuming, without deciding the issue, that the court could allow a late complaint objecting to discharge or a late motion to extend, the equities do not justify such a result in the F&D/Morrison case. F&D has admitted that it was aware of the bankruptcy petition two weeks after it was filed, that it attended the first meeting of creditors, and that it had five weeks after the conclusion of the

meeting to either file a motion to extend time, or the nondischargeability complaint itself.

F&D was actively represented by attorneys throughout the time period. The creditor chose not to do anything until one day after the deadline ran out. F&D was late due only to its choice, not to anything the debtors did or did not do. "Any harm to [F&D] could have been avoided by simply following Rule 4007.", to paraphrase Williamson, 15 F.3d at 1040. The factual equities of this case do not demand an extension, even if this court found it had the right to do so.

CONCLUSION

The creditor's motion to extend the deadline for filing a nondischargeability complaint against Morrison after July 11, 2005, must be **DENIED.** The court will enter a separate order which is consistent with these findings pursuant to Fed. R. Bankr. P. 7052.

DONE and ORDERED this November 17, 2005.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

JASON M. and CINDY M. TODD, **BK 05-73920-CMS-13**

DEBTORS.

ORDER FINDING SECURITY INTEREST IS NOT
PURCHASE MONEY SECURITY INTEREST IN MEANING OF § 1325(a)

This matter was before the court on creditor Money Source Inc.'s objection to the confirmation of debtors Jason M. and Cindy M. Todd's proposed Chapter 13 plan. Debtors' plan bifurcated the Money Source's auto loan into secured and unsecured claims under 11 U.S.C. § 506(a). The Money Source contended its interest could not be valued because of the recent amendments to 11 U.S.C. § 1325(a).

The court announced from the bench that the paragraph cited did not apply to refinancing loans; and valued the vehicle at $3,100.00 for plan purposes. The court held that the creditor's objection to confirmation/valuation would be **OVERRULED** as to that objection; but **SUSTAINED** as to the creditor's request for proof of insurance.

This order is the written memorialization of that bench order.

This court has jurisdiction of the Todds' bankruptcy case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of these contested matters, core proceedings under the Bankruptcy Code, pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court, pursuant to 28 U.S.C. §157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, As amended July 17, 1984.

Since the Todds filed their Chapter 13 petition on November 2, 2005, their bankruptcy case is governed by the new Bankruptcy Abuse Prevention Consumer Protection Act (BAPCPA) which took effect October 17, 2005.

The court makes the following findings:

FINDINGS OF FACT

Jason M. Todd testified at hearing that he purchased a 1992 Ford Explorer with funds loaned him by Autonet, Inc. (Autonet), more than 910[1] days before the November 2, 2005, bankruptcy filing. The parties agreed that at the time Autonet made the loan, debtors granted it a security interest in the Ford Explorer, creating a purchase money security interest.

On August 11, 2005, the Todds obtained a loan from The Money Source, Inc. (Money Source). Money Source paid the amount the Todds owed Autonet in full and also took its own security interest in the Ford Explorer. The parties agreed that this security interest would be deemed perfected by certificate of title on August 11, 2005. At the February 21, 2006, hearing, the parties agreed that the second loan comprised a refinancing transaction. (Creditor's counsel told the court that Autonet and Money Source were separate business entities, but shared a common owner and address.)

On November 2, 2005, the Todds filed this Chapter 13 case. Their plan proposed to pay allowed secured claims in full, but to provide no distribution to unsecured creditors. On November 11, 2005, the debtors filed this **MOTION TO DETERMINE VALUE** of the Explorer against Autonet, the original lender. They asked the court to determine the replacement value of this collateral to be $3,100.00 and to bifurcate the creditor's eventual $6,774.53 claim into secured and unsecured

[1] Money Source's certificate of title, submitted with its objection, stated the Todds' original purchase date for the Ford Explorer, used, was June 30, 2004. The title does not specify who they bought the vehicle from.

portions under 11 U.S.C. § 506(a). (BK Doc. 14).

On January 16, 2006, Money Source entered the case by filing an objection (BK Doc. 30, as amended by BK Doc. 37) to the proposed treatment of its debt under the debtors' plan. (BK Doc. 27). Money Source's motion contended that under the amended § 1325(a), the Todds could not "strip down" its debt into secured and unsecured portions as would have been allowed under former law. The parties agreed that the August 11, 2005, loan date is within 910 days of the bankruptcy filing. Money Source also complained that the Todds had allowed the insurance on the vehicle to lapse. For these reasons, the creditor asked the court to deny confirmation of the debtors' proposed reorganization plan.

Money Source stated in its amended motion that it had paid Autonet's debt off and "In addition, the Debtors received a cash pay out of $789.38." Attached documents show the loan was at an interest rate of 30.18 percent per annum.

The court heard Jason M. Todd's testimony in support of his motion to value and confirmation at the February 21, 2006, hearing. While Todd contended that, as far as he knew, the vehicle was insured, this issue was not resolved definitively at the hearing. Money Source offered no additional testimonial evidence. Counsel for both parties then made their arguments.

At the end of the hearing, the court announced that it disagreed with Money Source's major objection. The reasons are set out below:

CONCLUSIONS OF LAW

11 U.S.C. § 1325(a)(5) states that a plan will be confirmed if:

... [W]ith respect to each allowed secured claim provided for by the plan-

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that —

(I) the holder of such claim retain the lien securing such claim until the earlier of-

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; ...

At the end of § 1325(a)'s other enumerations, the BAPCPA amendments tacked on a new un-numbered paragraph[2] which reads as follows:

> ... For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day (sic) preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.
>
> It is undisputed that the Todds purchased the Explorer, a motor vehicle, for their personal use.

However, for Money Source to take advantage of the new language added to § 1325(a), the creditor

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[2] The legislative history for this amendment simply states that Section 306(b) of BAPCPA "adds a new paragraph to section 1325(a)" of the old act. (HR Rep. No. 31, 109th Cong. , 1st Sess. 309 (2005)). Typographically, however, one revised code elided the additional paragraph with Section 1325(a)(9), making it appear to be part of that section. See Mini-Code Special Redlined Edition, AWHFY, L.P., 2005; and Norton, William L. Jr., Bankruptcy Code and Related Legislative History Editorial Commentary, Thomson West, (2005-2006). If the house report is accurate, Congress intended the paragraph to stand alone, since it is unrelated to the first sentence of (a)(9).

must have a legally cognizable "purchase money security interest" in the Ford. The court found that Money Source does not hold a purchase money security interest based on the following analysis.

The Bankruptcy Code itself does not define the term "purchase money security interest" as used in revised § 1325(a). As is often the case in bankruptcy, the court must look to relevant state law to determine what the term encompasses. Matter of Hillard, 198 B.R. 620, 622 (Bankr. N.D. Ala. 1996). Because all of the events giving rise to this proceeding took place in Alabama and it is the forum state for this Bankruptcy Court, the court will look to Alabama law for the definition.

Section 7-9A-103(a) of the Alabama Code (the secured transaction article under the state's version of the Uniform Commercial Code) states "'purchase-money collateral' means goods or software that secures a purchase-money obligation incurred with respect to that collateral; ... ." The section then states "'purchase-money obligation' means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used."

Autonet clearly acquired a purchase money security interest in the vehicle at the time of the sale because the creditor supplied the funds/value which allowed debtors to buy it. However, the debtors already owned the Explorer before Money Source, Inc., loaned them money to pay off Autonet's prior debt; and to provide them with an extra $789.38 in cash. The Money Source loan, therefore, did not "enable the [debtors] to acquire rights in or the use of the [motor vehicle]".

An exception to the rule does not apply. Under Alabama law, a debt arising out of a non-consumer goods (commercial) transaction does not lose its purchase money status when the debt is refinanced. See Ala. Code § 7-9A-103(f). Section 7-9A-102(23) defines consumer goods as "goods that are used or bought for use primarily for personal, family, or household purposes." Section 7-9A-

102(24) defines a consumer goods transaction as "a consumer transaction in which: ... (A) an individual incurs an obligation primarily for personal, family, or household purposes; and (B) a security interest in consumer goods secures the obligation."

Because it is undisputed that the debtors acquired the Explorer for personal use, their transaction with both Autonet and Money Source is a consumer, rather than "non-consumer" transaction under Alabama law. Consequently, the Section 7-9A-103(f) exception cannot apply.

The court concluded that since the Money Store did not hold a purchase money security interest in the Explorer within the meaning of Alabama law, it did not hold a purchase money security interest under 11 U.S.C. § 1325(a) either. In the Middle District of Alabama, Bankruptcy Judge Dwight H. Williams entered a written decision reaching the same conclusion on February 23, 2006. See In re Horn, 2006 WL 416314 (Bankr. M.D. Ala. 2006).

Because § 1325(a) clearly states that a creditor must have a purchase money security interest in collateral in order to assert that such collateral cannot be valued under § 506(a), the court held that the special exception in the new § 1325(a) cannot protect Money Source from the valuation of its collateral. That ruling is based on the specific facts of this case.

For these reasons, the court enters the following order. It is hereby

ORDERED, DECREED, and ADJUDGED:

1. Money Store's **OBJECTION TO CONFIRMATION** (BK 30, as amended by BK 37) is hereby **OVERRULED** to the extent the creditor claimed it was not subject to § 506(a) valuation pursuant to revised § 1325(a).

2. The Todds' **MOTION TO VALUE** (BK 14) is hereby **GRANTED** to the extent that the court found the Explorer's value is found to be $3,100.00 pursuant to 11 U.S.C. § 506(a). (That valuation has already been entered by separate order. (BK Doc. 44)) The creditor's secured claim will be a allowed at $3,100.00, to be paid through the confirmed Chapter 13 plan (The separate confirmation order was entered as BK Doc. 42.)

3. However, the court hereby **SUSTAINS** Money Source's objection seeking proof of insurance on the collateral, the evidence at hearing being inconclusive. The court hereby **ORDERS** debtors Jason M. and Cindy M. Todd to provide the creditor with proof of insurance on the vehicle within 14 days of entry of this order. If the debtor fails to comply with this order, the stay of § 362(a) will lift without further order from this court.

This writing includes the courts findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052, and the orders required to implement them.

DONE and ORDERED this March 14, 2006.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
WESTERN DIVISION

IN RE: **BK 01-70137-CMS-13**

ELEANOR JAMES-RUMLEY,

DEBTOR.

MEMORANDUM OF DECISION

This matter was set for hearing on the Chapter 13 trustee's motion to modify the debtor's plan to increase distribution to unsecured creditors (Bk Doc. 74) and on debtor Eleanor James-Rumley's objection to the trustee's motion. (Bk Doc. 77) The court has reviewed the evidence in the context of applicable law and finds the trustee's motion must be **DENIED**, and the debtor's objection must be **SUSTAINED**.

FINDINGS OF FACT

The parties stipulated at a February 23, 2006 hearing that there is no dispute as to the facts giving rise to this motion and objection:

January 17, 2001, Eleanor James-Rumley filed her Chapter 13 bankruptcy petition with the court. James-Rumley included a schedule of assets with the petition. It did not list any prepetition causes of action against any party as her property; and, consequently, of the bankruptcy estate. The debtor also submitted a proposed reorganization plan, which provided that she would pay Chapter 13 Trustee C. David Cottingham $525.00 per month for 60 months to pay an approximate $31,500.00 in prepetition debt. She proposed to pay 0% percent to her unsecured creditors under the plan.

Following an April 3, 2001 hearing, the court entered an order of confirmation (BK Doc. 15, original NIBS Doc. 14) which set the term of the debtor's plan at 60 months, and required James-Rumley to pay $620.00 per month to the trustee, a higher plan payment than originally proposed. The confirmed plan also provided that the unsecured claims would be paid 0%, as originally proposed. Paragraph 4 of the confirmation order stated that "the property of the estate shall not vest in the debtor until the discharge is granted under Section 1328 or the case is dismissed." Subsequent to confirmation, the debtor's plan payments were modified several times: to $776.00 per month (Bk Doc. 22, original NIBS Doc. 21); to $670.00 per month (Bk Doc. 27, original NIBS Doc. 26); and to $560.00 per month (Bk Doc. 36, original NIBS Doc. 35). No other provisions of the confirmation order were modified by these adjustments of the payments.

On November 9, 2004, Bankruptcy Administrator Joseph E. Bulgarella filed a motion for status conference, stating at Paragraph 5 that "upon information and belief, a cause of action is pending." (BK Doc. 38) At that time, the debtor's schedule of assets had not been amended to reflect any lawsuit. December 3, 2004, the law firm of Utsey & Utsey filed an application to be employed to represent the debtor (Bk Doc. 42). This application stated that the firm was representing James-Rumley in an ongoing litigation filed August 22, 2003 in the Circuit Court of Sumter County, Alabama. December 9, 2004, the court entered an order approving the employment of Utsey & Utsey as attorneys for debtor in the state court action. (Bk Doc. 44) A copy of this order was also provided to the Chapter 13 trustee. The parties stipulated at the February 23, 2006 hearing that the lawsuit was based on prepetition occurrences, although it was actually filed postpetition in 2003.

On June 24, 2005, Utsey & Utsey filed a motion requesting compensation and expenses for

their services on James-Rumley's behalf (Bk Doc. 53); and followed up on June 27, 2005, with a motion to approve settlement of the pending state court action (Bk Doc. 55). These matters were set for hearing July 28, 2005 with notice to the Chapter 13 Trustee. No objections were filed to the proposed compensation and settlement. An order was entered August 2, 2005 approving the compromise and awarding the fees to debtor's state court counsel. (Bk Doc. 65)

At this point, the debtor still had not amended her schedules to reflect that she had a pending cause of action, nor had the trustee filed any motion to amend the confirmed plan to increase the percentage paid to unsecured creditors. After the approval order was entered, the trustee testified that on October 18, 2006 he received a lump sum payment which was sufficient to pay all allowed claims in the case at the amount provided for in the original confirmation order.

After payment to the trustee, the debtor on December 28, 2005, amended Schedule B of her petition to reflect the state court suit as property (Bk Doc. 71); and amended her Schedule C to claim $1,875.00 of the proceeds as exempt. (Bk Doc. 72) January 4, 2006, the trustee filed a motion to amend the plan to increase the distribution to unsecured creditors from the originally confirmed 0% to 41% based on the debtor's "disposable income". He based his percentage on a continued payment of $560.00 per month. (Bk Doc. 74)

January 11, 2006, the debtor objected to the trustee's proposed modification (Bk Doc. 77), asserting that the trustee was barred from amending the plan pursuant to 11 U.S.C. § 1329. The debtor contended the proceeds belonged to her, and not to her prepetition bankruptcy estate.

The parties stipulated at hearing that the debtor had paid the trustee's office enough money to pay all allowed claims under the plan by the time the trustee filed his January of 2006 motion to modify. The parties also agreed that the trustee had not yet distributed these funds to creditors when

he filed the motion. It was not until the trustee's February 2006 distribution that the money actually went out to creditors to pay all claims provided for in the original plan. The trustee stated at the February of 2006 hearing, that he had not filed a final report of a completed plan, nor had James-Rumley's discharge been entered.

The trustee has not accused the debtor of attempting to defraud her creditors or otherwise showing affirmative bad faith because she failed to list the cause of action earlier in the case.

The parties also agreed that the dispute turned on whether the trustee's motion was filed timely under the "completion of payments under such plan" language in Section 1329(a). The debtor's counsel contended the motion was untimely filed, and due to be denied based on this language. The trustee asked the court to find that, since the motion was filed in the 59th month of what was a 60-month plan, it was timely and that he be allowed to distribute funds to unsecured creditors.

The court took the issue under submission for a decision following the hearing.

CONCLUSIONS OF LAW

This court has jurisdiction of Eleanor James-Rumley's Chapter 13 bankruptcy case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this contested matter, a core bankruptcy proceeding arising under 11 U.S.C. § 1329, under 28 U.S.C. § 1334(b). Jurisdiction is referred to this Bankruptcy Court by the General Order of Reference of the United States District Courts for the Northern District of Alabama, signed July 16, 1984, As Amended July 17, 1984.

Section 1329 (a) of the Bankruptcy Code provides the following:

Modification of plan after confirmation

(a) At any time after confirmation of the plan but before the completion of payments under

such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to –

> (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan; ... (emphasis added)

Cottingham sought to amend James-Rumley's plan to allow a distribution to unsecured creditors, a valid statutory reason for modification under Section 1329(a)(1). The only legal dispute between the parties is as to the timeliness of the trustee's motion. At hearing, the parties argued the varying court interpretations of the phrase "before the completion of payments under such plan...", including: 1. When the debtor has made all payments required by the plan as confirmed (generally, the debtor's position), see In re Phelps, 149 B.R. 534, 539 (Bankr. N.D. Ill. 1993); 2. When the debtor has paid the trustee and the trustee has actually paid the debtor's plan creditors in full (generally, the trustee's position) see In re Casper, 153 B.R. 544, 548 (Bankr. N.D. Ill. 1993), rev'd by Casper v. McCullough (Matter of Casper), 154 B.R. 243, 247 (N.D. Ill. 1993); or 3. When the stated term of the plan ends (be that at the end of 36 or 60 months)(also the trustee's position).

The court's review finds that published case law almost universally interprets the phrase to mean the first alternative – when the debtor has delivered the entire amount due under the plan to the trustee. However, the court has not located a case in which all the facts are equivalent to the James-Rumley circumstance.

The following are samples of the opinions taking the majority view, but which are nevertheless distinguishable, to one degree or another, from this debtor's case:

See In re Bergolla, 232 B.R. 515, 516 (Bankr. S.D. Fla. 1999) (Debtors paid the trustee a lump sum only five months into their plan equaling the entire amount due in the remaining 56 months. The court held "... [t]he Debtors should receive a discharge when, in good faith, the balance

of a confirmed Chapter 13 Plan is paid early using proceeds from the sale of exempt property, in this case homestead property.");

Casper v. McCollough (Matter of Casper), 154 B.R. 243, 247 (N.D. Ill. 1993), rev'g In re Casper, 153 B.R. 544 (Bankr. N.D. Ill. 1993) ("completion of payments" under Section 1329(a) occurs when the debtor pays the trustee the full amount needed to pay off creditors as provided in plan);

In re Sounakhene, 249 B.R. 801, 806 (Bankr. S.D. Cal. 2000) (where debtors refinanced their home to pay the trustee a lump sum before expiration of the 36-month term of plan, the court held the trustee could not modify the plan to increase distribution to unsecured creditors under Section 1329(a) because debtors had completed all payments under the plan);

In re Jacobs, 263 B.R. 39, 44 (Bankr. N.D. N.Y. 2001) (where debtors had paid more than the plan required over its full term, trustee could not later modify their plan under Section 1329(a) to retrieve subsequent $20,000.00 settlement for prepetition creditors);

In re Smith, 237 B.R. 621, 626 (Bankr. E.D. Tex. 1999) (case where a family gift paid off debtor's Chapter 13 case early, court found that "without providing advance notice to any party, a Chapter 13 debtor may tender all payments due and owing under a confirmed plan on an accelerated basis and thereby create an entitlement to discharge.");

In re DeBerry, 183 B.R. 716, 717 (Bankr. M.D. N.C. 1995) (where debtors had paid off their Chapter 13 plan, their plan could not be modified to "provide for" postpetition IRS claim; and IRS would be granted relief from stay to collect against them);

In re Phelps, 149 B.R. 534, 539 (Bankr. N.D. Ill. 1993) (holding "that 'completion of payments,' as that phrase is used in § 1329(a), means completion of payments by the debtor to the

trustee ...";

In re Moss, 91 B.R. 563, 565 (Bankr. C.D. Cal. 1988) (holding "the plan cannot be modified because the debtor has made all payments called for by the plan ...");

In re Pritchett, 55 B.R. 557, 560 (Bankr. W.D. Va. 1985) (holding a Chapter 13 plan could not be modified because the debtor had completed her plan);

In re Profit, 283 B.R. 567, 573 (9th Cir. BAP 2002) (where debtors failed to remit tax refunds to trustee required as payments under the plan; and trustee moved for modification before the refunds were turned over, the court found trustee's motion was timely under Section 1329(a)); and

In re Richardson, 283 B.R. 783, 802 (Bankr. D. Kan. 2002) (holding "[s]ince the debtors have completed their plan payments in this case, the trustee can no longer obtain modification of the plan to effect the result he desires ...")

This court agrees with this majority rule, a strict construction of the plain, and unambiguous, text of Section 1329(a). If Congress had intended to attach additional conditions to the cutoff event for post-confirmation modification, it could have done so with equally plain language.

James-Rumley should have amended her schedules as soon as she knew of the cause of action. There is no evidence one way or another to prove her awareness or lack of awareness of the cause of action when she filed her bankruptcy petition. But certainly, the schedules should have been amended when suit was filed in 2003 in state court.

Whatever fault rests with the debtor, she and her state court counsel filed an application to employ him for the Sumter County litigation in December of 2004 with notice to her Chapter 13 trustee. In June of 2005, the debtor and her counsel returned to court to seeking approval of the consent judgment negotiated, and of counsel's fees and expenses. Full notice was again given to all

interested parties, including the trustee.

Still more time elapsed before October 18, 2005, when the trustee's office received settlement proceeds sufficient to pay off the creditors as provided in the plan, with funds left over. The court finds that the "completion of payments under such plan" language in Section 1329(a), means that the time for amending the James-Rumley plan terminated after that October 18, 2005 payment.

Consequently, the trustee's January 4, 2006 motion to amend the plan to provide a 41 percent distribution to unsecured creditors was not timely filed. For that reason, it must be denied.

CONCLUSION

The court must hold that Chapter 13 Trustee Cottingham's **MOTION TO INCREASE PERCENTAGE** (BK Doc. 74) is due to be **DENIED** as untimely filed; and that debtor Eleanor James-Rumley's **OBJECTION TO TRUSTEE'S MOTION TO INCREASE PERCENTAGE** (BK Doc. 77) is due to be **SUSTAINED**.

An order, consistent with these findings pursuant to Fed. R. Bankr. P. 7052, will be entered separately.

DONE and ORDERED this May 10, 2006.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

GERTHIA L. STERLING, **BK 00-71700-CMS-13**

DEBTOR.

GERTHIA L. STERLING, **AP 05-70060-CMS**

PLAINTIFF,

vs.

CENTERONE FINANCIAL SERVICES, LLC;
MITSUBISHI MOTORS CREDIT OF AMERICA, INC.;
and OMNI RECOVERY SERVICE OF ALABAMA, INC.,

DEFENDANTS.

MEMORANDUM OF DECISION

This matter is before the court on creditor/defendants' request that this federal Bankruptcy Court try this removed lawsuit. The debtor opposes the reopening of her bankruptcy case, and trial of her state law complaint in federal court. She seeks remand to state court where she filed suit. The court finds it can exercise subject matter jurisdiction of this lawsuit under 28 U.S.C. § 1334(b) without reopening BK 00-71700, and that it is appropriate to do so. For the reasons stated below, debtor's motion to remand is to be **DENIED,** and the creditors motion to reopen is due to be **DENIED.**

FINDINGS OF FACT

Facts relating to Gerthia L. Sterling's bankruptcy case come from the court's records in bankruptcy case 2000-71700-CMS-13. The facts relating to the post discharge repossession of Ms. Sterling's automobile are those alleged in the parties' pleadings. Gerthia L. Sterling, an employee of a nursing home in Northport, Alabama, purchased a new Mitsubishi Mirage on credit from Contemporary Mitsubishi in Tuscaloosa, Alabama in 1999. (See Proof of Claim No. 1) Defendant Mitsubishi Motors Credit of America LLC was the assignee of payment rights in the loan secured by the new car.

The following year, on July 18, 2000, Sterling filed a Chapter 13 petition with this Bankruptcy Court. (BK Doc. 1). The filing included Sterling's Chapter 13 Plan Summary. Paragraph II(B) of her plan provided "The holder of each SECURED claim shall retain the lien securing such claim until a discharge is granted and such claim shall be paid in full with interest at a rate of 10% per annum in deferred cash payments as follows:", and then, in paragraph II, it listed the secured creditors to be paid. Mitsubishi Motor Company was scheduled with the debtor estimating the total amount of the debt at $15,454.00, and the value of their collateral (a 1999 Mitsubishi Mirage) at $15,454.00. She did not attempt to bifurcate the value of the car under Section 506(a) to reduce the secured claim. Her plan proposed to grant the creditor a fixed payment of $353.07 at 10% interest, a lower interest rate than provided in the original contract. Under paragraph D, Special Provisions, the debtor's plan proposed "to pay Mitsubishi Motor Credit in 55 months as set out above."

On August 3, 2000, Mitsubishi Motors Credit Company of America, Inc., through counsel, filed its Claim No. 1 for a total amount of $19,278.64. Exhibit A to the claim itemized this total

amount and explained "secured claim is based on a present value of $15,414.27, capitalized at 10% (the rate proposed in the plan) for 55 months, resulting in monthly payment of $350.52 and a future value of $19,278.64." Exhibit A to Mitsubishi's claim evidenced that the actual amount of the debt was slightly less than the debtor's estimate for the plan. When paid at the 10% interest proposed in the plan over 55 months, the fixed payment to amortize the debt would be only $350.52 a month.

The court entered an order confirming the plan September 28, 2000. (Bk Doc. 7). Paragraph 2 of the confirmation order provided that "Secured creditors shall retain their liens securing such claim until such time as the filed and allowed claims of such creditors are paid under the terms of the Debtor's plan and said liens are released upon completion of the plan as confirmed or as amended." Paragraph 4 of the confirmation order further provided that "property of the estate shall not vest in the debtor until a discharge is granted under Section 1328 or the case is dismissed. ..."

Mitsubishi neither objected to the confirmation of the debtor's plan nor appealed the confirmation order.

On August 8, 2005, almost five years after Sterling's plan was confirmed, defendant CenterOne Financial Services, LLC (CenterOne, hereinafter the designation of both CenterOne and Mitsubishi) filed a notice that it had "acquired servicing of the loan" which was the basis of Mitsubishi's original claim as filed August 3, 2000. The notice further directed the Chapter 13 Trustee to transfer the claim and future payments to CenterOne (BK Doc. 15).

Shortly thereafter, on August 16, 2005, Chapter 13 Trustee C. David Cottingham filed a notice of withdrawal of the deduction order to the debtor's employer for the $186.00 bi-weekly plan payments, indicating that Sterling had remitted through her deduction order sufficient funds to pay out her case. (BK Doc. 16) Cottingham later stated he sent the last payment due on the car to

CenterOne in August of 2005.

On September 6, 2005 the trustee filed his certification of plan completion (BK Doc. 17). Trustee's certificate stated "...that upon information and belief, the Debtor has completed the Chapter 13 Plan. Accordingly, pursuant to 11 U.S.C. Section 1328(a), the Debtor is entitled to a discharge. The Trustee will file a Final Report and Account when all payments to creditors have cleared his bank account. The Trustee requests that the Court keep the case open pending receipt of the Final Report and Account."

On September 6, 2005, the Bankruptcy Court granted Sterling a discharge of personal liability for the debts provided for in her plan – including the creditor's allowed secured claim as to her vehicle. (BK Doc. 18) Both CenterOne and Mitsubishi were served with copies of the discharge order. (BK Doc. 19) No party appealed or disputed the order. After it became final, the file of the Sterling case was placed on the administrative track for formal closing.

Sterling alleges that on September 29, 2005, post-discharge, CenterOne, as agent for Mitsubishi, sent a demand letter directly to her seeking further payment. The creditor followed up with additional collection calls, as alleged by Sterling's **OPPOSITION TO MOTION TO REOPEN CHAPTER 13 BANKRUPTCY** (BK Doc. 28). Then, Sterling stated, the defendants repossessed her car on October 12, 2005.

On November 15, 2005, Sterling sued CenterOne, Mitsubishi, and Omni Recovery Service of Alabama under state law in Jefferson County Circuit Court, asking for trial by a struck jury. Sterling alleged that the following events took place after notice of her discharge was entered:

> After the discharge, Mitsubishi Credit and CenterOne made repeated attempts to collect from Sterling. They began sending her bills and making collection calls, threatening to repossess her car if she did not pay a balloon payment she allegedly owed on the car (even though all

> debt owed on the car was satisfied and discharged in the bankruptcy). When the calls and bills did not stop, Sterling called her Chapter 13 lawyer, Eric Wilson, for help. Mr. Wilson spoke with representatives of CenterOne, specifically instructing them that they could take no action against Ms. Sterling and that the debt had been discharged, and reminding them that CenterOne and Mitsubishi Credit had actual knowledge of the discharge and satisfaction because their counsel had been served with the discharge order.

See AP Doc. 8, Sterling's **MOTION TO REMAND or ABSTAIN and MOTION TO EXPEDITE CONSIDERATION of SAME.**

The debtor contends in this pleading and in the complaint removed from Jefferson County, that, following Wilson's call, CenterOne and Mitsubishi dispatched co-defendant Omni Recovery Services to repossess her car from the lot of the nursing home where she works. According to Sterling's allegations, Omni towed the car to a Jefferson County location (approximately 50 miles from this area) with personal items, including her purse, still inside; and that the vehicle had not been returned to her possession.

In her state lawsuit, she sought actual/compensatory, as well as punitive, money damages for the alleged circumstances of the repossession, based on state law causes of action. She did not sue on the basis of bankruptcy law, nor cite any other federal cause of action. Her bankruptcy case remained open at that point, but the normal procedures of case closing after discharge were proceeding in due course. No pleading was filed to halt that process in this court.

Chapter 13 Trustee Cottingham entered his final report in Sterling's Chapter 13 case on December 2, 2005, stating that his office had paid CenterOne/Mitsubishi a total $19,278.64 on its secured claim. (BK Doc. 20). On December 16, 2005, the Bankruptcy Court formally closed Sterling's bankruptcy case and discharged the trustee. (BK Doc. 23). At the time the bankruptcy case was formally closed, none of the defendants had answered the complaint in the Jefferson County lawsuit.

Instead of answering in state court, CenterOne and Mitsubishi on December 19, 2005 removed the state court lawsuit to this court under 28 U.S.C. § 1452 and Fed. R. Bankr. P. 9027. (AP Doc. 1) The creditors did not contend that any other bridge to federal jurisdiction existed. They did not seek removal to district court under 28 U.S.C. § 1441 for general federal question or diversity jurisdiction in the 30-day period allowed for doing so.[1] (Mitsubishi had filed a consent and joinder in the removal as well. CenterOne stated in its pleadings that Omni's consent was not required, since it had not been served in the Jefferson County case.[2])

On December 22, 2005, CenterOne answered Sterling's state law complaint in Bankruptcy Court, denying any liability to the debtor. Mitsubishi moved to dismiss the complaint as failing to state a claim on which relief could be granted. Generally, CenterOne, joined by Mitsubishi, argued in pleadings that the federal theory of "complete preemption" of state law by federal statute limited

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[1] **28 U.S.C. 1446** provides the following:

> (a) A defendant or defendants desiring to remove any civil action or criminal prosecution from a State court shall file in the district court of the United States for the district and division within which such action is pending a notice of removal signed pursuant to Rule 11 of the Federal Rules of Civil Procedure and containing a short and plain statement of the grounds for removal, together with a copy of all process, pleadings, and orders served upon such defendant or defendants in such action.
>
> (b) The notice of removal of a civil action or proceeding shall be filed within thirty days after the receipt by the defendant, through service or otherwise, of a copy of the initial pleading setting forth the claim for relief upon which such action or proceeding is based, or within thirty days after the service of summons upon the defendant if such initial pleading has then been filed in court and is not required to be served on the defendant, whichever period is shorter.

[2] Chief Judge Albritton of the Middle District of Alabama has held that complete joinder is not required for Section 1452 removal. See Retirement Systems of Alabama v. J.P. Morgan Chase & Co., et al., 285 B.R. 519, (M.D. Ala. 2002).

the plaintiff's choice of forum to U.S. District Court and/or its unit, the Bankruptcy Courts; and that her sole remedies were limited to those available under federal law. The creditor stated in its notice of removal:

> In the State Court Action, the Debtor seeks to recover damages based on the repossession of her Vehicle, efforts to collect the debt, and presumably violation of the permanent injunction contained in § 524(a) of the Bankruptcy Code under state law theories of conversion, breach of contract, outrage and trespass to chattels. Notwithstanding Debtor's effort to recast her claims in terms of tort and contract, this action clearly arises of, and directly relates to, the implementation and interpretation of the Court's Discharge Order. See 28 U.S.C. § 157(b)(2). Additionally, inherent in the State Court Action is Defendants' purported violation of the permanent injunction by repossessing certain property of Debtor following discharge. As such, the Bankruptcy Court is uniquely situated to hear, interpret and determine matters relating to its own Order and Defendants' alleged violation (of) that Order and the permanent injunction.(emphasis added)

However, the record does not reflect that creditors themselves sought interpretation and determination of the discharge order from this court before they invoked their alleged claim to a state law right of self-help repossession.

Sterling, on the other hand, argued that "complete preemption" could not apply to defeat the "well-pleaded complaint" rule, another doctrine applied in determining the existence of federal jurisdiction over state law suits. The plaintiff strongly opposed both removal of the lawsuit and reopening of her Chapter 13 case. She filed a motion to remand the litigation to state court which is also opposed by the defendants.

At hearing, creditors' counsel argued that the general equitable powers granted bankruptcy courts in 11 U.S.C. § 105(a)[3], coupled with Section 524's creation of the discharge injunction[4]

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[3] **11 U.S.C. 105(a)** provides the following:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of

"completely preempted" Sterling's access to other causes of action.

The court heard the arguments of counsel at a January 31, 2006 hearing, after which it took the issues under submission for a decision.

CONCLUSIONS OF LAW

This court had jurisdiction of Sterling's Chapter 13 case under 28 U.S.C. § 1334(a). The court has initial removal jurisdiction of this lawsuit pursuant to 28 U.S.C. § 1452(a) and 28 U.S.C. § 1334(b). The jurisdiction is referred to this court under 28 U.S.C. § 157(a) by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, As Amended July 17, 1984.

Defendants CenterOne, and Mitsubishi have asked this court to exercise jurisdiction of this state court lawsuit under the special bankruptcy removal authority of 28 U.S.C. § 1452. Mitsubishi has also moved to dismiss the plaintiff's state law complaint under Fed. R. Civ. P. 12(b)(6). The plaintiff, Sterling, opposes removal, trial in federal court, and reopening of her bankruptcy.

> an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

[4] **11 U.S.C. 524** provides the following:

> (a) A discharge in a case under this title— ...
>
> (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; and
>
> (3) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, ...

While subject matter jurisdiction is in issue here, it is clear that this Bankruptcy Court has, at least, the jurisdiction to determine the scope of its own jurisdiction. In doing so, the court must also analyze the creditors' "complete preemption" argument.

Federal courts have exclusive jurisdiction of debtors' main bankruptcy cases pursuant to 28 U.S.C. § 1334(a). By statute, a debtor cannot commence a Chapter 13 "case" in state court, nor can a state court administer a bankruptcy case.

On the other hand, 28 U.S.C. § 1334(b) provides original, but not exclusive, jurisdiction over some disputes which arise during or in connection with a bankruptcy case. State court can exercise a concurrent jurisdiction on such issues.

28 U.S.C. § 1334(b) provides the following:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11. (emphasis added)

At the very least, Section 1334(b) jurisdiction must exist in order for actions to be removed from state to bankruptcy court (as a unit of district court) under Section 1452. Section 1452(a) provides the following:

> A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title. (emphasis added)

Section 1452 bankruptcy removal is a separate and distinct removal jurisdiction from that provided by 28 U.S.C. § 1441 for cases qualifying for "federal question" or diversity jurisdiction before the district courts. Under Section 1452, defendants in a state court action may remove it to

the district courts, sitting/acting in their bankruptcy jurisdiction capacity; or more usually under a general reference, directly to the more jurisdictionally limited bankruptcy courts. The removal procedure set out in 28 U.S.C. § 1446 is applied to both Section 1452 and 1441 removals.

In some published cases, defendants have pleaded both § 1441 (federal question or diversity) and § 1452 (bankruptcy) removal. Business disputes often involve parties both inside and outside of the bankruptcy courts. And cases can both raise a general federal question and be under Section 1334(b) bankruptcy jurisdiction as well. However, the Sterling defendants have specifically chosen to rely only on Section 1452 removal. They have not pleaded "federal question" removal jurisdiction under Section 1441 within the 30 days allowed for doing so by Section 1446(b).

In Blakeley v. United Cable System, et al., 105 F.Supp.2d 574, 579 (S.D. Miss. 2000), the court stated:

> ... [T]he courts that have addressed the issue have uniformly recognized that a defendant's ability to amend the removal petition after the thirty-day time limit for removal prescribed by § 1446 extends only to "amendments to correct 'technical defects' in the jurisdictional allegations in the notice of removal," and that amendments to remedy a " a substantive defect in the petition", i.e., to add a new basis for federal jurisdiction are not permitted. See, e.g. Briarpatch Ltd. v. Pate, 81 F.Supp.2d 509, 516-17 (S.D. N.Y. 2000) ("[f]ailure to assert federal question jurisdiction as a basis for removal is a substantive defect" which defendant may not cure by amendment after expiration of thirty-day time limit of § 1446(b)); ...

Consequently, the defendants have waived any formal claim to "federal question" removal under Section 1441, although some of their arguments appeared to address the issue.

I.

This suit is a proper subject for removal pursuant to 28 U.S.C. § 1452, since it implicates the Section 1334(b) "arising under" bankruptcy jurisdiction.

A. Neither Sterling's causes of action against CenterOne/Mitsubishi, nor her car, are property of any bankruptcy estate under this court's jurisdiction.

Defendant CenterOne's detailed Notice of Removal (joined by Mitsubishi) and answer to Sterling's complaint contend that any proceeds of her lawsuit for wrongful repossession could be distributed to the unsecured creditors listed in her Chapter 13 case. Consequently, the creditor argued that resolution of the suit could impact her bankruptcy estate**.** That would be a basis for "related-to" jurisdiction under Section 1334(b) as predicate for Section 1452 removal.

The Eleventh Circuit Court of Appeals set the minimum standard for "related-to" jurisdiction under Section 1334(b) in Miller v. Kemira, Inc.(In re Lemco Gypsum, Inc.), 910 F.2d 784, 788 (11th Cir. 1990). The court adopted the definition found in Pacor v. Higgins, 743 F.2d 984, 994 (3rd Cir. 1984):

> ... "The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of the proceeding could conceivably have an effect on the estate being administered in bankruptcy. The proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts the handling and administration of the bankrupt estate (emphasis added)." ...

Sterling's confirmation order provided that all property of the bankruptcy estate would vest in the debtor upon her discharge pursuant to 11 U.S.C. § 1328. Her confirmation order also means that the estate's interest in the car itself terminated with her discharge. The creditor did not object to confirmation or appeal the confirmation order. On September 6, 2005, the court entered the discharge order and estate property did vest in Sterling. The creditor filed no objection to the discharge nor did it seek to vacate or appeal the discharge order later. Consequently, her estate would no longer have an interest in prepetition or postpetition causes of action, or the car itself. See Royal v. Daihatsu (In re Royal), 197 B.R. 341, 349 (Bankr. N.D. Ala. 1996); Roddam v. Metro Loans, Inc. (In re Roddam), 193 B.R. 971 (Bankr. N.D. Ala. 1996); and Wilson v. ALFA Companies, et al. (In

re Wilson), 207 B.R. 241, 247 (Bankr. N.D. Ala. 1996).

11 U.S.C. § 1329 (a) also provides that "At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee**,** or the holder of an allowed unsecured claim, ... (emphasis added)" The creditors did not request a modification of Sterling's plan before she completed her payments, before she received her discharge, or before her case was closed. Modification of her plan is no longer possible, another reason no recovery she might receive could benefit her prepetition creditors. This post-discharge cause of action belongs to Sterling alone.

Further, no acts occurring prepetition or during the active pendency of the case are in issue. In fact, the chain of events material to the Sterling dispute began after the debtor's successful completion of her confirmed plan and her September 6, 2005 discharge. By the time she filed the state case, her bankruptcy estate had ceased to exist. By December 19, 2005, when creditors removed the Sterling suit to Bankruptcy Court, no "case" existed either. It had been closed December 16, 2005.

In Old Republic Insurance Co. v. Farmer (In re Farmer), 324 B.R. 918 (Bankr. M.D. Ga. 2005), the bankruptcy court found that a personal injury claim arising out of an automobile accident which had occurred postpetition, postconfirmation, and after the debtors completed payments under their plan, was not included in "property of the estate". It appears to the court that the Sterling lawsuit and any proceeds it might generate would belong solely to Sterling – not to her Chapter 13 trustee or prepetition unsecured creditors. See In re Wilson, 207 B.R. at 247.

Since none of the proceeds that Sterling might recover in his lawsuit are property of the estate and are not subject to distribution to her discharged creditors, the lawsuit is not removable as "related

to" the bankruptcy case under Section 1334(b). Reopening the case file cannot change the fact that it is not possible for the proceeds to impact any bankruptcy estate.

B. However, the court does have Section 1334(b) original, but not exclusive, "arising under" jurisdiction of this dispute since substantial questions of bankruptcy law will inevitably determine its outcome .

The wording of Sterling's state court complaint makes no specific allegations that the CenterOne defendants violated any provision of the Bankruptcy Code. More particularly, she has made no specific allegations that CenterOne had violated the discharge injunction of 11 U.S.C. § 524(a). In fact, she has scrupulously avoided the use of the word "discharge" or "bankruptcy" in her complaint. Examples of the way she phrased her contention in the state court complaint that she was no longer indebted to CenterOne at the time of the alleged repossession include the following:

> 7. Plaintiff made all payments which she was legally required to make to pay off the debt made the subject of the Contract.
>
> 8. ... notwithstanding the fact that Mitsubishi Credit had been paid the entire amount of its Claim.
>
> 9. ...Plaintiff explained to the CenterOne representative that she had paid for the car in its entirety. ...
>
> 19. ...The Defendants knew that the Plaintiff had paid off the automobile in full. ...
>
> 22. ...Plaintiff made the required payments and paid for the car in full.

(Exhibit A to AP Doc. #1)

These allegations are only true if the debt was discharged in her bankruptcy case.

In deference to the well-pleaded complaint rule, Sterling has certainly avoided alleging any violations of the Bankruptcy Code or any other federal statute on the face of her pleading. Sterling's state court suit alleges purely state law causes of action. Her four-count complaint includes the

following: Count 1 - Conversion; Count 2 - Outrage; Count 3 - Breach of Contract; Count 4 - Trespass to Chattels. If the court considered the wording of the complaint alone, there would clearly be no basis for removal of this case to Bankruptcy Court. The case would be remanded to state court.

The court has found no published cases which definitively answer the issues raised by the parties under the facts of this case, though much case law exists in the rough vicinity of these facts.

There are several circuit court of appeals cases dealing with similar facts, but these cases were pled differently. The plaintiffs alleged in their complaints that a creditor had violated the Section 524(a) discharge injunction, but had claimed a non-bankruptcy law remedy for the code violations. See Walls v. Wells Fargo Bank, N.A., 276 F.3d 502 (9th Cir. 2002); Cox v. Zale Delaware, Inc., 239 F.3d 910 (7th Cir. 2001); Pertuso v. Ford Motor Credit Company, 233 F.3d 417 (6th Cir. 2000); and Bessette v. Avco Financial Services, Inc., 230 F.3d 439 (1st Cir. 2000). All of the plaintiffs originally filed their lawsuits in U.S. district court as purported class actions on behalf of bankruptcy court debtors. On appeal, each of these circuit courts cases found that the debtors' sole remedy was to bring a Section 105(a) action for violation of the Section 524 discharge injunction, holding there was no private right of action provided under Section 524.

In this case, Sterling originally filed her case in state court and has made no allegations that the discharge injunction has been violated, even though the facts alleged presuppose that the debt has been discharged, and that there was an effort to collect a discharged debt.

Sterling asserted that as plaintiff she is the master of her own complaint in deciding the law she will rely upon for any recovery against the defendants. The United States Supreme Court in Franchise Tax Board of the State of California v. Construction Laborers Vacation Trust for Southern

California, 463 U.S. 1, 22 (1983) held that "although we have often repeated that 'the party who brings the suit is master to decide what law he will rely upon,'... (citations omitted), it is an independent corollary of the well-pleaded complaint rule that a plaintiff may not defeat removal by omitting to plead necessary federal questions in a complaint, ...(citations omitted)". The Ninth Circuit in the case of Lippitt v. Raymond James Financial Services, Inc., 340 F.3d 1033, 1041 (9th Cir. 2003) referred to this removal concept based on "necessary federal questions" as the "artful pleading" doctrine, a term also used in 1980s Ninth Circuit precedents.

Every allegation in Sterling's complaint presupposes that her underlying debt to CenterOne has been discharged and that its lien on her automobile was extinguished in her bankruptcy case. These are outcome-determinative questions on every tort and contract claim she makes. That fact, though unspoken, is nevertheless apparent on the face of the complaint she filed in state court.

Sterling's grievances against the creditors will be determined by whether CenterOne still held an enforceable in rem interest in Sterling's car on October 15, 2005 when the creditor allegedly repossessed the vehicle and took it to Jefferson County. The status of the car's ownership – unencumbered, free and clear in favor of Sterling; or still encumbered by an in rem interest in favor of CenterOne -- must be resolved as a threshold question by any forum that tries this suit. In the traditional language of the law, the scope of Sterling's discharge order is the substantive gravamen of this dispute. Substantial and necessary questions of federal bankruptcy law determine the scope of the discharge.

If the secured, in rem debt was paid off in full under the confirmed Chapter 13 plan, any attempt by CenterOne to collect would appear to be wrongful. If there was no debt owed to CenterOne, and there was no lien on Sterling's automobile, there could have been a trespass or a

conversion of her property under Alabama law. A creditor's lien can be permanently extinguished during the Chapter 13 process. The extinguishment can permanently remove the encumbrance and that status will continue after Section 1334(a) jurisdiction ends. However, it does not represent the "paid for the car in its entirety" and similar allegations Sterling made in her complaint which imply a state law "satisfaction" to the creditor.

Sterling has not chosen to allege specifically that the underlying debt was discharged in her bankruptcy case, or make a claim for any violation of the Bankruptcy Code in her state complaint. She has not sought amendment of the removed complaint in this Bankruptcy Court to do so.

However, this court cannot ignore the fact that all legal issues in this dispute turn on substantial questions of federal bankruptcy law - the effect of 11 U.S.C. § 1325 confirmation of Sterling's plan on CenterOne's contractual rights; the effect of Sterling's discharge under 11 U.S.C. § 1328 on CenterOne's in rem rights in her automobile; or the 11 U.S.C. §524 effects of Sterling's discharge injunction. These underlying issues are removable matters under 28 U.S.C. § 1452 which "arise under" the Bankruptcy Code, in the same way that general federal questions "arise under" federal law, the Constitution, and treaties for 28 U.S.C. § 1441 removal.

The United States Supreme Court in Merrell Dow Pharmaceuticals, Inc. v. Thompson, 478 U.S. 804, 808 (1986) held that a case can arise under federal law if a state court cause of action depends upon the resolution of a substantial question of federal law. The case involved the Section 1331 general federal question jurisdiction of the district court, and not the Section 1334(b) "arising under" jurisdiction of the bankruptcy courts. However, its reasoning is instructive. The court emphasized the narrow construction to be used in identifying this class of cases. This is not a broad grant of jurisdiction.

As a court stated in Ormet Corporation v. Ohio Power Company, 98 F.3d 799, 806 (4th Cir. 1996) "there is a small class of cases where, even though the cause of action is not created by federal law, the case's resolution depends on resolution of a federal question sufficiently substantial to arise under federal law within the meaning of 28 U.S.C. Section 1331". Ormet was interpreting the Supreme Court's Franchise Tax Board and Merrell Dow.

The court is convinced the Bankruptcy Court's own "arising under" Section 1334(b) jurisdiction is sufficient to support defendants' removal pursuant to 28 U.S.C. § 1452(a).

As stated in Beneficial National Bank v. Anderson, 539 U.S. 1, 8 (2003):

> Thus, a state claim may be removed to federal court in only two circumstances – when Congress expressly so provides, such as in the Price-Anderson Act, supra, at 2062, or when a federal statute wholly displaces the state-law cause of action though complete pre-emption. ... n. 3 Of course, a state claim can also be removed through the use of the supplemental jurisdiction statute, 28 U.S.C. § 1367(a), provided that another claim in the complaint is removable.

Congress "expressly" provided this court a concurrent jurisdiction with state courts under Section 1334(b) and then provided a special removal statute under Section 1452 which depended on that jurisdiction. Under 28 U.S.C. § 1367(a), if a state suit is removable as to one issue, the district court may also exercise pendent jurisdiction of state law causes of action in the complaint.

II.

While the court can exercise jurisdiction of this suit, it declines to extend the "complete preemption" doctrine to state law affecting creditor/former debtor relations after bankruptcy.

CenterOne's main arguments for removal to federal court appeared to be that either the Bankruptcy Code, in general; or Sections 524 and 105, in particular, have completely preempted all Sterling's state law remedies for an indefinite period.

When "complete preemption" takes place, all of the plaintiff's state remedies are totally displaced by federal law; and, by operation of law, converted to a federal cause of action. In this case, "complete preemption", arguably, would "convert" all of Sterling's state claims into whatever remedy could be found under the Bankruptcy Code. If that logic were adopted, the Bankruptcy Court/district court would have "arising under" jurisdiction of this dispute and Sterling's damages would be limited to those available for Section 524 violation as enforced by the court under 11 U.S.C. § 105(a). If the former debtor/plaintiff declined to amend her complaint to state such a federal claim, her suit would have to be dismissed since it would not state a claim for which federal relief could be granted.

11 U.S.C. § 524 creates the discharge injunction but does not specifically set out any private remedies for its violation. The Sixth Circuit Court of Appeals in Pertuso v. Ford Motor Credit Company, 233 F.3d 417 (6th Cir. 2000), for example, found there was no private right of action for violation of the discharge injunction. The Eleventh Circuit of Appeals has not specifically ruled on whether a private right of action exists for violations of the discharge order. However, the appeals court has ruled that a bankruptcy court has the power to award "coercive" damages for violations of the Section 524 discharge injunction through its statutory contempt/equitable powers under 11 U.S.C. § 105(a). See Hardy v. Internal Revenue Service, (In re Hardy) 97 F.3d 1384 (11th Cir. 1996).

The Court in Hardy quoted from a companion precedent, Jove Engineering, Inc. v. Internal Revenue Service, (In re Jove) 92 F.3d 1539 (1996) (involving remedies for violation of the automatic stay). The Court said in Hardy that:

Section 105 grants statutory contempt powers in the bankruptcy context, stating "The court

> may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Section 105 creates a statutory contempt power, distinct from the court's inherent contempt powers in bankruptcy proceedings, for which Congress unequivocally waives sovereign immunity. Jove, 92 F.3d at 1553. The language of § 105 encompasses "any type of order, whether injunctive, compensative or punitive, as long as it is 'necessary or appropriate to carry out the provisions of the Bankruptcy Code." Id. At 1553-54. Therefore, "§ 105(a) grants courts independent statutory powers to award monetary and other forms of relief for automatic stay violations to the extent such awards are 'necessary and appropriate" to carry out the provisions of the Bankruptcy Code." Id. ... (emphasis added)
>
> ... In Jove, this court adopted a two-pronged test to determine willfulness in violating the automatic stay provision of § 362. Under this test, the court will find the defendant in contempt if it: "(1) knew that the automatic stay was invoked and (2) intended the actions which violated the stay." Jove, 92 F.3d at 1555. This test is likewise applicable to determining willfulness for violations of the discharge injunction of § 524. (emphasis added)

Hardy, 97 F.3d at 1389-90.

The U.S. Internal Revenue Service was the defendant in both of these cases. Jove discussed the Bankruptcy Court's Section 105(a) powers in connection with an alleged violation of the Section 362(a) automatic stay. In Hardy, the Eleventh Circuit reversed a district court finding of no jurisdiction in an action for violation of the discharge order. It remanded the case to the district court stating: "The court may find IRS in contempt under § 105 by finding that the IRS acted willfully, according to the test set forth in the companion case of Jove." Hardy, 97 F.3d at 1391.

The defendants have argued that the 2003 case of Beneficial National Bank v. Anderson, 539 U.S. 1 (2003) requires the court to find that Sterling's only remedy is available through Section 524 and 105(a) by Anderson's broadening the applicability of the doctrine of "complete preemption." This court cannot read Anderson or subsequent Supreme Court of the United States or Eleventh Circuit precedent to authorize, much less require, this sweeping result. See Aetna Health Inc. v. Davila. 542 U.S. 200 (2004); and Dunlap, et al. v. G&L Holding Group Incorporated, et al., 381 F.3d

1285 (11th Cir. 2004).

Anderson resolved an important, but narrowly drawn, question on the scope of the general federal question jurisdiction of the district courts. The Supreme Court's holding involved serious constitutional questions of separation of powers and of federalism. The judgment required consideration of the potential for judicial interference with Congress's power to determine the jurisdiction of lower federal courts, and with the states' normally plenary jurisdiction to resolve disputes in their own courts. CenterOne's "complete preemption" contentions in reference to the Bankruptcy Code implicate these same constitutional issues.

In 1991, the Eighth Circuit Court of Appeals held that Section 86 of the federal National Bank Act (NBA) had completely preempted all state law usury claims in M. Nahas & Co. Inc. v. First National Bank of Hot Springs, 930 F.2d 608, 612 (8th Cir. 1991). It was the first and only lasting circuit court precedent on this issue until the Eleventh Circuit's Anderson decision in 2002. However, the theory of "complete preemption" had been extensively litigated in many state law vs. federal law situations. The courts had arrived at differing outcomes.[5]

Prior to 2003, the Supreme Court had limited "complete preemption" to two areas of federal/state law – (1) claims involving labor/management relations governed by Section 301 of the Labor Management Relations Act of 1947, and (2) claims under benefit plans governed by the

[5]In the bankruptcy context, many cases involved the impact of defective reaffirmation agreements on the scope of the discharge. See Bessette v. AVCO Financial Services, Inc. , 230 F.3d 439 (1st Cir. 2000); Pertuso v. Ford Motor Credit Company, 233 F.3d 417 (6th Cir. 2000); Cox v. Zale Delaware, Inc., 239 F.3d 910 (7th Cir. 2001); and Walls v. Wells Fargo Bank, N.A., 276 F.3d 502 (9th Cir. 2002) (all purported class actions filed in federal court originally and pleading discharge violation specifically); as well as in other contexts, including the pre-Anderson MSR Exploration, Ltd. v. Meridian Oil, Inc., et al., 74 F.3d 910 (9th Cir. 1996). While these cases offer surface similarities to Sterling case, none are sufficiently on point factually or legally to render even persuasive guidance to this court.

Employee Retirement Income Security Act of 1974 (ERISA). (29 U.S.C. §§ 1001 et seq.)

Textually, Anderson, itself, set a much narrower precedent than CenterOne asks this Bankruptcy Court to adopt. That is shown by the way Justice Stevens phrased the issue:

> The question in this case is whether an action filed in a state court to recover damages from a national bank for allegedly charging excessive interest in violation of both "the common law usury doctrine" and an Alabama usury statute may be removed to a federal court because it actually arises under federal law. We hold that it may.

Anderson, 539 U.S. at 3-4.

The Anderson plaintiffs had sued alleging that their tax preparer H&R Block Inc., and the bank had colluded to overcharge them for loans secured by the tax refunds H&R Block computed. They had sued in state court under Alabama's common law and statutory usury prohibitions.

With the law in an unsettled state, the District Court for the Middle District of Alabama, declined to remand the removed Anderson complaint to state court, but certified the issue of its own federal question jurisdiction directly to the Eleventh Circuit Court of Appeals. See Anderson v. H&R Block, et al., 287 F.3d 1038, 1042 (11th Cir. 2002), rev'd by Beneficial National Bank, et al. v. Anderson, 539 U.S. 1 (2003).

The Eleventh Circuit's 2002 answer to the question later posed by Justice Stevens was "no." The circuit court held that complete preemption of state law had not taken place, and the lawsuit was not a proper subject for general federal question removal under 28 U.S.C. § 1441. A three-judge panel ruled two-to-one that the existence of a federal defense (compliance with Sections 85 and 86 of NBA) to the state law claims was only "ordinary," not "complete," preemption; and that the federal issue could be properly raised and adjudicated in state court. Traditionally, a federal defense, without more, did not defeat the "well-pleaded complaint" rule to allow removal to federal court

under Section 1441 over the plaintiff's objection. See Anderson, 539 U.S. at 6; Silkwood v. Kerr-McGee Corporation, 464 U.S. 238, 248 (1984), and Caterpillar, Inc. v. Williams, 482 U.S. 386, 393 (1987).

In Anderson, the Supreme Court reached the opposite legal conclusion based on the same facts and law, and reversed the Eleventh Circuit. It had granted certiorari to resolve the one-one split of authority at circuit court level. The Court's 2003 ruling came on a 7-2 vote, with Justices Scalia and Thomas dissenting.

The Supreme Court in Anderson then set out two distinct instances when state claims may be removed to federal court under general federal question jurisdiction:

> Thus, a state claim may be removed to federal court in only two circumstances-when Congress expressly so provides, such as in the Price-Anderson Act, supra, at 2062, or when a federal statute wholly displaces the state-law cause of action through complete preemption... In the two categories of cases where this Court has found complete pre-emption - certain causes of action under the LRMA and ERISA-the federal statutes at issue provided the exclusive cause of action for the claim asserted and also set forth procedures and remedies governing that cause of action. See 29 U.S.C. § 1132 (setting forth procedures and remedies for civil claims under ERISA); § 185 (describing procedures and remedies for suits under LRMA)... Sections 85 and 86 serve distinct purposes. The former sets forth the substantive limits on the rates of interest that national banks may charge. The latter sets forth the elements of a usury claim against a national bank, provides for a 2- year statute of limitations for such a claim, and prescribes the remedies available to borrowers who are charged higher rates and the procedures governing such a claim..."

Anderson, 539 U.S. at 8, 9.

As shown by the briefings of the parties and the court's own research, the decision has sparked much litigation – involving a wide array of federal/state legal interaction, in addition to cases involving national banks. Defendants who favor federal fora and/or the perceived limited damages available there have argued strongly for expansion of the Anderson rule. The judgments of the courts

in other jurisdictions have not been consistent, including those involving bankruptcy.[6] None have been factually or legally identical enough to Sterling to provide much persuasive authority.

While the Eleventh Circuit Court of Appeals has not yet applied the Supreme Court's Anderson rule to a case involving Sections 85 and 86 of NBA, it has stated a post-Anderson definition of where "complete preemption" now applies. See Dunlap v. G&L Holding Group Incorporated, et al., 381 F.3d 1285 (11th Cir. 2004). The court stated:

> The Supreme Court has admonished that federal law should be found to completely preempt state law "only in statutes with 'extraordinary' preemptive force." Geddes, 321 F.3d at 1353. To date the Supreme Court has identified only three statutes that completely preempt related state-law claims: (1) § 301 of the Labor Management Relations Act, 29 U.S.C. § 185; (2) § 1132 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, et seq.; and (3) §§ 85 and 86 of the National Bank Act, 12 U.S.C. § 21 et seq. See Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 7-11, 123 S.Ct. 2058, 2062-64, 156 L.Ed.2d 1 (2003). The Court found that complete preemption applied to those statutes because all three "provided the exclusive cause of action for the claim asserted and also set forth procedures and remedies governing that cause of action." Id. at 8, 123 S.Ct. 2063. Accordingly, the "touchstone" of federal question jurisdiction based on complete preemption is congressional intent. ...

Dunlap, 381 F.3d at 1291.

The Sterling action does not involve a debtor-creditor dispute during the pendency of the bankruptcy case. The facts giving rise to this dispute allegedly occurred after Sterling's bankruptcy case was completed and she was granted a discharge. The case was not removed until after the bankruptcy case had been closed. Neither United States Supreme Court nor Eleventh Circuit cases mention the Bankruptcy Code or any individual section of the code as "extraordinary preemptive

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[6] See Nelson, et al. v. Stewart, et al., 422 F.3d 463 (7th Cir. 2005) (11 U.S.C. 1114 did not completely preempt retirees' state law causes of action against their own union for negligent representation in former employer's Chapter 11); but see Miles, et al. v. Okun, et al. (In re Miles), 430 F.3d 1083 (9th Cir. 2005) (11 U.S.C. 303(I) completely preempted state law remedies when Bankruptcy Court had already ruled on liability and specifically retained jurisdiction to liquidate damages.)

force" as to completely preempting state law matters. Their holdings do show that complete preemption is the exception and not the rule. This court declines to extend the application of complete preemption to this post discharge debtor creditor dispute.

The Sterling case was properly removed under 28 U.S.C. § 1452 because resolution of all the state law issues depends on substantial questions of federal bankruptcy law (the effect of 11 U.S.C. § 1325 confirmation of Sterling's plan on CenterOne's contractual rights; the effect of Sterling's discharge under 11 U.S.C. § 1328 on CenterOne's in rem rights in her automobile; and the effect of the 11 U.S.C. § 524 discharge). These are all matters "arising under" the Bankruptcy Code. Section 1334(b) expressly provides that the District Court "shall have original but not exclusive jurisdiction" of such "arising under" disputes. The question now is whether this bankruptcy court should or should not remand this suit to Jefferson County Circuit Court for equitable reasons as provided under Section 1452(b).

III.

In the interest of judicial economy and for other equitable reasons, the court will retain jurisdiction of this lawsuit pursuant to 28 U.S.C. §§ 1452(b) and 1334(b).

28 U.S.C. § 1452(b) provides the following:

> The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title. (emphasis added)

Generally, bankruptcy courts have analyzed all the circumstances of each case as they balance the equities of the remand question under Section 1452. The logical framework used by this and many other bankruptcy courts originated in Browning v. Navarro, 743 F.2d 1069, 1077 at n. 21 (5th

Cir. 1984).[7] The analysis in this case is more difficult than usual, even excluding the novel question of "complete preemption".

The heart of Sterling's complaint is the legal consequences of the confirmation of her plan and the entry of her discharge as they relate to the rights of CenterOne. These are questions which are addressed by bankruptcy courts on a daily basis. They are issues which state courts would probably prefer never to deal with; and, when they must deal with them, do so rarely. Not only does the bankruptcy court have more expertise on these questions, but the bankruptcy court ruling on these issues would lessen the likelihood of inconsistent results between federal and state court.

The removal of this case to bankruptcy court does not create a forum nonconveniens problem for either party. Sterling lives and works in Tuscaloosa County. The creditors have asked that the case be heard in Tuscaloosa County. Therefore retention of the case here does not impose additional hardship for plaintiff or defendants.

This action has not been bifurcated by its removal to bankruptcy court. There is no longer a case in state court by virtue of its removal to this court. See Federal Rule of Bankruptcy Procedure 9027. Therefore, bifurcation is not a factor in deciding whether this case should be remanded. The

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[7] The Browning factors (in this court's paraphrase) include the following issues: 1. Does removal create a forum non conveniens problem or vice versa?; 2. If a civil action has been bifurcated by removal, the entire action should be tried by the same court.; 3. Is one court better than another for resolving the legal questions raised?; 4. Does one court have a more useful expertise in trying the particular questions raised by the removed case?; 5. Will use of two forums result in duplicative and uneconomical use of judicial resources?; 6. Will the involuntarily removed parties be prejudiced?; 7. As in all such decisions, the court should be sensitive to issues of comity with state courts.; 8. As much as possible, the court's remand decision should lessen the possibility of inconsistent result.

The Fifth Circuit, in the 1984 case, was considering former 28 U.S.C. 1478, which was reenacted as a somewhat amended 28 U.S.C. 1452(b). The "... may remand such claim or cause of action on any equitable ground" language has continued forward unchanged in the current statute.

action filed in Jefferson County Circuit Court was immediately removed to bankruptcy court. Therefore, the Jefferson County court has not used any judicial resources in this case. All matters since the action was filed have been in the bankruptcy court which has now reacquainted itself with the underlying bankruptcy case, as well as this post discharge lawsuit. This would favor the case remaining in bankruptcy court.

The complicated question to be resolved is the core vs. noncore nature of these proceedings. To the extent matters are core proceedings, the bankruptcy court can enter final judgments. To the extent that matters are noncore proceedings, then the bankruptcy court only makes recommended findings of facts and conclusions of law and sends them to the District Court for consideration. There is also a jury demand and bankruptcy court does not try jury cases without the consent of all parties. If, in fact, a jury trial appears necessary, then the bankruptcy court may still hear and enter final orders on all pretrial motions, including outcome determinative summary judgment motions. After all pretrial motions are resolved, the bankruptcy court then can send any remaining matters to be tried by a jury in the U.S. District Court. While this complicates the procedural handling of the case, the court believes that the importance of the underlying bankruptcy questions outweighs any procedural complications.

For these reasons and with due regard to comity considerations with state courts, the bankruptcy court declines to remand AP05-70060 to Jefferson County Circuit Court.

CONCLUSION

The court declines to remand this removed lawsuit to Jefferson County Circuit Court where it was filed. Consequently, Sterling's **MOTION TO REMAND or ABSTAIN and MOTION TO EXPEDITE CONSIDERATION of SAME** (AP Doc. 8) must be **DENIED**.

Orders, consistent with these findings pursuant to Fed. R. Bankr. P. 7052, will be entered separately.

DONE and ORDERED this May 12, 2006.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
WESTERN DIVISION

IN RE:

BK 03-73899-CMS-13

CHARLES HUBERT ANTHONY, and
DONNA KAYE MARLOWE ANTHONY,

DEBTORS.

AP 04-70007-CMS

C. DAVID COTTINGHAM,
as Chapter 13 Trustee

PLAINTIFFS

VS

ALABAMA CREDIT UNION,

DEFENDANT.

MEMORANDUM OF DECISION

This case is before the court in BK 03-73899 for confirmation on debtors' proposed plan of reorganization and Alabama Credit Union's objection. It is also before the court on AP 04-70007 which challenges Alabama Credit Union's liens on debtors' automobiles, requests the turnover of titles to the vehicles, and asserts that the credit union violated the automatic stay. For the reasons indicated below, the court **OVERRULES** Alabama Credit Union's objection to confirmation of the debtors' plan and an order of confirmation will be entered. The court further finds that the credit union's lien is due to be avoided pursuant to 11 U.S.C. Section 547 and that the credit union violated the automatic stay when it perfected its lien postpetition. The court **DENIES** the request for turnover of the titles.

FINDING OF FACTS

The debtors, Charles H. Anthony and Donna K. Anthony, are the owners of a 1994 Honda Accord, a 1994 Toyota Camry, and a 1995 Chevrolet C1500 truck. Prior to the filing

of their bankruptcy petition these automobiles served as collateral for a loan at Citizens Bank of Fayette (Citizens Bank). In August of 2003, Mr. Anthony went to Alabama Credit Union (credit union) to discuss refinancing of the loan with the credit union. It was Mr. Anthony's testimony that the credit union loan would save him approximately $100.00 per month in payments. Included in Plaintiff's Exhibit 1, marked as page 1-4, is a copy of a LOANLINER Open-End Disbursement Receipt Plus (Receipt Plus) form with a date of August 21, 2003, and pages 1-14 and 1-15 are copies of title applications on two of the subject automobiles dated August 21, 2003. From the testimony it appears that this is the date the Anthony's made their application for a loan with the credit union. According to the testimony of Donna Allison, branch manager and loan officer with the credit union, the loan was approved on September 5, 2003 and page 1-5 in Plaintiff's Exhibit 1 is a LOANLINER Open-End Plan Signatures PLUS (Signature Plus) form signed by the debtors and dated September 5, 2003. Also included in Plaintiff's Exhibit 1 at page 1-3 is a second Receipt Plus form dated September 30, 2003.

The first Receipt Plus form (Plaintiff's Exhibit 1, page 1-4) dated August 21, 2003 has the account number 39551 30 and pledges the three cars owned by the Anthonys as collateral with an annual percentage rate on the loan of 4.1%. The amount financed is $17,237.35, with a monthly payment of $509.74, with the first payment due September 21, 2003.

The second Receipt Plus form(Plaintiff's Exhibit 1, page 1-3) is dated September 30, 2003 and again pledges as collateral the Anthonys' three automobiles. The interest rate is 4.7% and the amount financed is $17,312.34, with a monthly payment of $511.92, with the first payment due October 30, 2003. The account number is 39551 31. Neither of these Receipt Plus documents are signed.

As noted earlier, pages 1-14 and 1-15 of Plaintiff's Exhibit 1 indicate that the title applications were dated August 21, 2003.

Mr. Anthony's testimony as to the chronology of events is as follows:

On approximately August 21, 2003 he first went to the credit union and talked about this loan. He returned to the credit union on September 8, 2003 and paid the credit union $16.50 for

each of the three automobile title applications which were being submitted on behalf of the credit union. These payments for the title applications were on September 8, 2003, not August 21, 2003. The next payment was due at Citizens Bank on September 15, 2003 and it was his understanding that the credit union would pay off this account prior to that date. Defendant's Exhibit 1 is a copy of an authorization signed by Mr. and Mrs. Anthony and the credit union authorizing Citizens Bank to accept $17,237.35 to pay off the three subject automobiles and is captioned "NOTICE FOR AUTHORIZATION FOR PAYOFF AND DEMAND FOR TITLE". The date appears to be September 19, 2003. Plaintiff's Exhibit 3 is a copy of a notice dated September 26, 2003 from Citizens Bank to Mr. Anthony advising him that his loan payment is due, and written on the notice is the number 17,312.34 until 2:30 tomorrow. That is the same amount indicated on Plaintiff's Exhibit 1 at page 1-3 for the amount of funds being advanced on September 30, 2003. This is greater than the amount shown on Defendant's Exhibit 1 which showed the amount to be paid as $17,237.35, the same amount indicated on Plaintiff's Exhibit 1 at page 1-4 on the August 21, 2003 Receipt Plus agreement. What appears to have happened is the credit union failed to disburse the funds to Citizens Bank before the September 2003 payment was due; and therefore, additional interest and a late charge were added to the amount required to pay off the Citizens Bank balance.

After receiving the late notice from the Citizens Bank, Mr. Anthony went to the credit union to find out what had happened. The credit union then gave him a check and a piece of paper to take to Citizens Bank to pay off the Citizens Bank loan. He testified that he took Defendant's Exhibit 1, along with the check to Citizens Bank. Citizens Bank gave him his note marked paid and the three titles to his automobiles with the liens released. He took them home, rather than returning them to the credit union. He made payments to the credit union in October and December and received no inquiry from the credit union concerning the titles. On December 9, 2003, he did receive a telephone call from the credit union about the location of the titles. When he advised them that he had them, they asked him to return the titles to them, and he did so that same day. The next day, December 10, 2003, he had an appointment with his

attorney. The Anthonys' bankruptcy petition was filed December 12, 2003.

January 5, 2004, the credit union mailed the title applications to the State of Alabama, and Plaintiff's Exhibit 1 at page 1-14 indicates that at least two of the applications were received January 15, 2004.

In summary, the evidence shows that on October 1, 2003 Alabama Credit Union advanced funds on behalf of the Anthonys which paid their loan at Citizens Bank, which was secured by the Anthonys' three automobiles. Sometime prior to October 1, 2003, either August 21, 2003, September 5, 2003, September 8, 2003, or September 30, 2003, the Anthonys granted the credit union a security interest in these three automobiles. On December 12, 2003, when the bankruptcy petition was filed, the credit union had in its possession the three titles, but had not submitted these titles to the Alabama Department of Revenue in order to perfect their lien on the automobiles.

The debtors filed their plan, along with their schedules, December 12, 2003. Under their plan, the debtors treated the credit union as an unsecured creditor and proposed to pay all unsecured creditors, including the credit union, the liquidation value of the three automobiles.

January 22, 2004, the credit union filed its claim asserting that it was a secured creditor in the amount of $16,499.82. (Proof of Claim #3) The credit union asserted that it held a lien on the debtors' three automobiles.

February 2, 2004, the debtors objected to the credit union's claim (Doc. 5) and alleged that the credit union was either an unsecured creditor on the date of filing or the holder of an avoidable lien. February 5, 2004 the debtors also filed AP 04-70007. Count One of the complaint alleged that the perfection of the credit union's lien was a preferential transfer under 11 U.S.C. Section 547. Count Two requested an order that the credit union turn over to the debtor titles to the automobiles with all claimed liens noted as released. Paragraph Three alleged that the credit union perfected its lien after the debtors filed their petition; and therefore, violated the automatic stay under 11 U.S.C. Section 362.

February 3, 2004, the credit union objected to confirmation (BK Doc. 8).

April 14, 2004 debtors moved for summary judgment (AP Doc. 8); and, on June 16, 2004, the credit union filed its MOTION FOR SUMMARY JUDGMENT (AP Doc. 17).

August 5, 2004, the debtors filed a MOTION TO SUBSTITUTE C. DAVID COTTINGHAM, CHAPTER 13 TRUSTEE AS PLAINTIFF (AP Doc. 26) which was granted September 9, 2004 (AP Doc. 31). The debtors' motion for summary judgment was denied August 26, 2004 (AP Doc. 29). The credit union's motion for summary judgment was denied February 24, 2005 and the matter was set for trial March 3, 2005.

CONCLUSIONS OF LAW

This court has jurisdiction of Charles H. Anthony's and Donna K. Anthony's Chapter 13 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this adversary proceeding, a core bankruptcy proceeding as listed at 28 U.S.C. §§ 157(b)(2)(E), (F), and (K), pursuant to 28 U.S.C. § 1334(b). The jurisdiction is referred to this court, pursuant to 28 U.S.C. § 157(a), by the General Order of Reference of the United States District Courts for the Northern District of Alabama, Signed July 16, 1984, As Amended July 17,1984.

The relief the trustee seeks in his lawsuit, the debtors' objection the classification of the credit union's claim, and the credit union's objection to confirmation of the Anthonys' Chapter 13 plan arise from the same facts and are governed by the same set of legal conclusions. Consequently, the court will deem all issues subsumed into the discussion in this Memorandum of Decision. The memorandum and its accompanying orders will address all issues, with orders consistent with these findings entered in both BK 03-73899-CMS-13 and AP 04-70007.

The issues raised in this case are as follows:

1. Should the credit union's lien be avoided pursuant to 11 U.S.C. § 547?

2. Should the credit union be required to turn over the titles to the debtors' vehicles, and release its liens?

3. Did the credit union violate the automatic stay when it perfected its lien postpetition?

4. Should the debtors' plan be confirmed over the objection of the credit union?

5. Should the debtors' objection to the secured classification of the credit union's claim be sustained?

I.

The trustee may avoid Alabama Credit Union's lien in the Anthonys' vehicles.

Count One of the complaint in this adversary proceeding, originally filed by the debtors and now prosecuted by the trustee, does not state that it is brought as a preference action pursuant to 11 U.S.C. §547. However, it recites all of the elements required by Section 547(b) as the basis for such avoidance.

The facts show that on the date the Anthonys filed bankruptcy, the credit union had in its possession titles to all three automobiles, but had not applied to the State Department of Revenue for new titles showing the credit union as first lienholder. Usually in such circumstances, a trustee would sue the creditor under 11 U.S.C. § 544(a), since his interest as a hypothetical judgment lienor as of the December 12, 2003 petition date, would take priority over the credit union's unperfected security interest. In this case, the trustee was required to specifically prove five factual elements to be successful in a Section 547(b) challenge.

Section 547(b) provides as follows:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made –
> (A) on or within 90 days before the date of the filing of the petition; or
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
> (5) that enables such creditor to receive more than such creditor would receive if –
> (A) the case were a case under Chapter 7 of this title;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The transfer at issue is the Anthonys' grant of a security interest to the credit union and the creditor's subsequent failure to timely perfect that interest in its collateral. For it is undisputed that the facts show the credit union had not fulfilled the legal requirements for perfection until more than a month after bankruptcy.

Section 547(e) defines when a "transfer" takes place in the meaning of 547(b). When such

a transfer has not been perfected on the petition date, Section 547(e)(2)(C) provides that the transfer is deemed made "immediately before the date of the filing of the petition, if such transfer is not perfected at the later of – (i) the commencement of the case; or (ii) 10 days after such transfer takes effect between the transferor and the transferee." Since the credit union's security interest was not perfected until more than 10 days after the bankruptcy itself, under Section 547(e), it is deemed to have occurred on the petition date, December 12, 2003.

As for the elements needed to prove a Section 547 preference, the court has analyzed these facts in the following way:

As required by Section 547(b)(1), the Anthonys' grant of a security interest to the creditor as collateral for its loan is clearly a transfer "to or for the benefit of a creditor." Under Section 547(b)(2), the debtors' grant of the security interest was also "on account of an antecedent debt." Although the parties offered different dates for the credit union's payment of the Anthony's debt, the latest was October 1, 2003. That date and the debt it created is "antecedent" to December 12, 2003, when Section 547(e) sets the unperfected transfer of the security interest.

Pursuant to Section 547(b)(3), the Anthonys must also have been insolvent at the time of the challenged transfer. Section 547(f) creates the presumption that debtors are insolvent for the 90 days before they file bankruptcy, and no evidence in this case contradicts that presumption. Therefore, the Anthonys were insolvent in the meaning of the Section 547(b).

Section 547(b)(4) requires that the transfer have taken place "on or within 90 days" before bankruptcy was filed. Since the transfer is deemed to have occurred "immediately before" the filing of the petition on December 12, 2003, it is within the required 90 days.

Section 547(b)(5) requires that a preference must be a transfer allowing the creditor to receive more in a Chapter 7 liquidation than it would have if the transfer were avoided.

In the Chapter 7 liquidation context, if the credit union held an unperfected lien as of the petition date, its collateral would be sold by the trustee and the proceeds distributed pro-rata to all the Anthonys' unsecured creditors. Those unsecured creditors would include the credit union if the transfer is avoided. Since the vehicles comprise the only non-exempt assets of the Anthony

bankruptcy estate, the credit union would get only a pro-rata share of the sale proceeds, along with other unsecured creditors. If the transfer is not avoided, the credit union would get 100 percent of the sale proceeds, and the other creditors would get nothing. Consequently, if the transfer stands, it would allow the credit union to receive more than it would have received in a Chapter 7 liquidation.

Consequently, the record facts show that the Anthony/Alabama Credit Union transaction met all the elements required for avoidance under Section 547(b).

The credit union asserted the equitable doctrine of earmarking as a defense in this case. "Earmarking" is a judicially created exception to Section 547(b) avoidance. Collier on Bankruptcy, Alan N. Resnick and Henry J. Sommer, 15th Ed., described earmarking in the following way at Paragraph 547.03[2]:

> Under the "earmarking doctrine," funds provided to a debtor for the purpose of paying a specific indebtedness may not be recoverable as a preference from the creditor to which they are paid, on the premise that the property "transferred" in such a situation was never property of the debtor and so the transfer did not disadvantage other creditors.

A bankruptcy court discussed earmarking in Vieira v. Anna National Bank (In re Messamore), 250 B.R. 913, (Bankr. S.D. Ill. 2000). Messamore involved a refinancing transaction almost identical to the case at hand. The court stated:

> The earmarking doctrine, as developed in case law, is clearly applicable in a refinancing situation to determine whether the debtor's payment of an existing creditor with funds borrowed from a new creditor constitutes a preferential transfer–that is, whether such payment is a transfer of the debtor's "interest in property" to pay the debt owed to the first creditor. This case, however, presents an entirely different question. Here, it is not the transfer of the funds to the debtors' original creditor, Green Point, that is at issue, but the transfer that occurred when the new creditor, Anna Bank, perfected its lien on the debtors' mobile home more than 10 days after execution of the parties' loan agreement. Under the definition of "transfer" applicable in preference actions, the debtors' transfer of an interest in their mobile home did not occur at the time of the loan transaction when they incurred their obligation to Anna Bank. Rather, because Anna Bank failed to perfect within 10 days after the parties' transaction, transfer of the debtors' interest is deemed to have occurred at the time Anna Bank perfected its loan over two months later. See 11 U.S.C. § 547(e)(2)(B). It is this latter transfer, the transfer of the debtors' interest in the mobile home to Anna Bank to secure their pre-existent obligation, that the trustee alleges is preferential. Although the debtors' transfer to Anna Bank arose in the context of a refinancing arrangement, it did not involve payment of funds by a third party or, indeed, the payment of borrowed funds at all. For this reason, the earmarking doctrine has no logical relevance to such transfer. The transfer to Anna Bank that occurred upon perfection of its lien was separate and distinct from the transfer that occurred when Green Point was paid with the borrowed funds, and this transfer was clearly a transfer of the debtors' interest in property, as it depended on the debtors' grant of a security interest to Anna Bank. The earmarking doctrine, therefore is inapplicable in the present case to shield the debtors' transfer to Anna Bank from avoidance

as a preference.

See Messamore, 250 B.R. at 917.

Scaffidi v. Kenosha City Credit Union and State of Wisconsin (In re Moeri), 300 B.R. 326, (Bankr. E.D. Wisc. 2003) also involved a refinancing creditor which tardily perfected its lien in the refinanced vehicle. The court followed Messamore, stating:

> Judge Meyers pointed out that, while the earmarking doctrine may apply to payments of funds from a subsequent creditor to the original creditor, it has no application with respect to the subsequent creditor's obligation to timely record its lien, which is a separate and distinct transfer.

See Moeri, 300 B.R. at 329.

The transfer at issue in the Anthony case, like the transfers in Messamore and Moeri, is the perfection of the credit union's own lien on the debtor's automobiles, not the credit union's payment/transfer to Citizens Bank for release of that bank's prior lien. Therefore, the court finds the credit union's lien constitutes an avoidable preference under Section 547(b) and is preserved for the benefit of the bankruptcy estate pursuant to 11 U.S.C. § 551. Section 551 provides the following:

> **Automatic preservation of avoided transfer.**
>
> Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate. (emphasis added)

The trustee (as creditors' representative) has been substituted as plaintiff in place of the Anthonys. Consequently, the debtors' original request for turnover of the titles under Section 542, and release of the liens is due to be denied at this point.

Further, 11 U.S.C. § 349 provides for reinstatement of the avoided liens if the Anthonys do not complete payments under their plan. Section 349(b)(1)(B) states:

> **Effect of dismissal.**
> (b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under section 742 of this title–
> (1) reinstates–
> (B) any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or preserved under section 510(c)(2), 522(i)(2), or 551 of this title; ...

So it is premature to grant the request for turnover or release of the liens at this point in the case.

Additionally, the complaint is correct in its allegation that the credit union's action to perfect its lien postpetition is a technical violation of the automatic stay pursuant to 11 U.S.C. § 362(a)(4)[1]. However, there is no evidence that the estate or the debtors suffered damage as a result pursuant to 11 U.S.C. § 362(h)[2]. As a result, the credit union has no liability for the technical violation.

Consequently, judgment is to be entered in favor of the Chapter 13 trustee, and against the creditor on the Section 547(b) avoidance claim.

II.

The Anthonys' Chapter 13 plan is due to be confirmed; the credit union's objection is to be overruled; and the debtors' objection to the creditors' secured classification, sustained.

While the debtors' transfer of their interest in the cars is to be avoided, Section 551 preserves the interest for the benefit of the estate, not of the individual debtors. 11 U.S.C. § 1325 sets out the requirements a Chapter 13 plan must satisfy to be confirmed.

11 U.S.C. § 1325(a)(4) is commonly referred to "the best interest of creditors test" meaning that the plan must provide that:

(a) Except as provided in subsection (b), the court shall confirm a plan if– ...

> (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date; ...

At the least, the Anthonys must pay unsecured creditors the value of the three autos as of the

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[1] **Section 362(a)(4)** provides the following:

Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of– ...

> (4) any act to create, perfect, or enforce any lien against property of the estate; ...

[2] **Section 362(h)** provides the following:

An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

effective date of the plan. The parties have stipulated that the autos had a value of $16,550.00 as of the date of filing. The Anthonys' plan proposed to pay unsecured creditors $18,596.00. That distribution would represent the present value of the autos, with interest, paid to creditors over the life of the plan as required by Section 1325(a)(4).

The credit union's objection to confirmation of the plan protested the Anthonys' treatment of the creditor's claim as unsecured, rather than secured. The facts in McRoberts v. TranSouth Financial (In re Bell), 194 B.R. 192 (Bankr. S.D. Ill. 1996) were virtually identical to the Anthony case. The trustee in Bell avoided a creditor's liens in automobiles because it had failed to perfect its security interest prior to the bankruptcy filing. The court found that the unperfected lien creditor would be an unsecured creditor under terms of the Chapter 13 plan; that unsecured creditors would receive the liquidation value of the vehicles pursuant to Section 1325(a)(4); and that, upon successful completion of payments under the plan terms, the debtor would own the automobiles free and clear of the creditor's lien.

The Anthonys' plan, as proposed, is therefore due to be confirmed, and the credit union's objection to confirmation overruled.

The credit union had filed Proof of Claim 3 for $16,499.82 as a secured claim. The Anthonys had objected to the classification of Claim 3 as secured, asserting it should be allowed as unsecured. The debtors did not dispute the amount of the claim. The creditor's lien has been avoided by the trustee. As stated in Bell, 194 B.R. at 197:

> [T]he trustee's avoidance of the creditors' liens results in nullification of the transfer of property represented by those liens, and the security transactions are ineffective not only as to the trustee but also as to the debtor and creditor themselves as the immediate parties to the transactions.

Therefore, the debtors objection to the secured status of the claim is due to be sustained, and the credit union's Claim 3 is allowed as unsecured in the amount of $16,499.82. As noted in Bell, while the liens have been avoided in this bankruptcy case, they are subject to reinstatement if the case is dismissed prior to the Anthonys' Chapter 13 discharge.

CONCLUSION

In summary, the court finds judgment in AP 04-70007 must be entered **IN FAVOR OF THE**

TRUSTEE, and **AGAINST THE ALABAMA CREDIT UNION** on the Section 547(b) avoidance of the credit union's lien. Further, in BK 03-73899, the court finds that the Anthonys's Chapter 13 plan, as proposed, is **DUE TO BE CONFIRMED**; the creditor's objection to confirmation **OVERRULED;** and the debtors' objection to the secured status of the claim, **SUSTAINED**.

Orders, consistent with these findings pursuant to Fed. R. Bankr. R. 7052, will be entered separately.

DONE and ORDERED this June 28, 2005.

/s/ C. Michael Stilson

C. Michael Stilson

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

JERRY LUTHER SMELLEY, JR.
and LISA GRAMMER SMELLEY, **BK 05-73529-CMS-13**

DEBTORS.

MEMORANDUM OF DECISION

This matter was set for hearing on confirmation of the debtors' (Jerry Luther Smelley, Jr. and Lisa Grammer Smelley (Smelleys)) amended plan of reorganization (BK Doc. 38), the objection of Marie S. Brown (Brown) to the confirmation of the plan (BK Doc. 49), and the Chapter 13 trustee's motion to dismiss the case without confirmation (BK Doc. 14). The court has considered the evidence presented in court, the arguments of parties, and the court's file in this case and finds that Brown's objection is due to be **OVERRULED** and the amended plan of reorganization, **CONFIRMED**.

FINDINGS OF FACT

The debtors filed a petition for bankruptcy reorganization on October 13, 2005. Notice was sent to all scheduled creditors, including Brown, advising that February 15, 2006 was the deadline for filing claims to share in the distribution under the debtor's plan (BK Doc. 6). There is no dispute that this notice was received by Brown.

The original plan of reorganization submitted by the Smelleys (BK Doc. 4) provided for no distribution to unsecured creditors including Brown. Brown had been scheduled as an unsecured creditor with an unliquidated claim listed as "a disputed lawsuit" in the amount of $1.00. Brown had

filed a lawsuit in Tuscaloosa County Circuit Court in 2004 alleging that the debtor Lisa Smelley had fraudulently used a power or powers of attorney to use funds from Brown's savings account and to obtain proceeds from a mortgage on Brown's property. Debtor Lisa Smelley testified that Brown is her husband's great-aunt. Brown's claim of fraudulent conduct is directed against debtor Lisa Smelley, and not debtor Jerry Smelley. For the purposes of this confirmation hearing the court will assume the Brown's allegations against debtor Lisa Smelley are true, although the debtor denies the allegations.

The Tuscaloosa County Circuit Court case had already been pending for approximately two years when the bankruptcy petition was filed. There was no evidence that it was set for trial or at any other critical point, at or about the time the bankruptcy petition was filed.

After the bankruptcy filing, Brown filed no objection to confirmation of the debtors' original plan even though it provided no payment to unsecured creditors. Additionally, she did not file a claim as a creditor.

On the other hand, two of Lisa Smelley's co-defendants in Brown's state court lawsuit did file objections to the confirmation of the debtors' first plan. After a February 8, 2006 hearing, the court sustained these two objections, and granted the debtors until February 14, 2006 to file an amended plan. (BK Doc. 35) The order also specified that if the debtors did not file an amended plan by February 14, 2006, the case would be dismissed without further hearing. Brown's attorney was also present at the February 8, 2006 hearing.

The Smelleys filed their amended plan on February 14, 2006 as directed, and provided that unsecured creditors would be paid 100%. Brown still had not filed a claim to be allowed as a creditor in the case, nor had she filed an objection to confirmation. The claims bar date passed on

February 15, 2006. Subsequently, on February 17, 2006, Brown filed her Proof of Claim No. 14.

On March 7, 2006, Brown did file an objection to the confirmation of the amended 100% plan. (BK Doc. 49) She alleged that the Smelleys' plan had not been filed in good faith as required by 11 U.S.C. § 1325(a)(3) and should not be confirmed. The Smelleys also filed an objection to Brown's Claim 14 (BK Doc. 44), asking the court to disallow it as tardily filed.

A hearing was conducted on March 28, 2006 and the court sustained the debtors' objection to Brown's claim (BK Doc. 57), and disallowed Claim 14 because it was filed after the bar date. By agreement, Brown's objection to confirmation, and the trustee's motion to dismiss were continued to April 10, 2006 for trial.

At the April 10, 2006 hearing, Lisa Smelley testified that the Smelleys' financial difficulties resulted from their attempt to open a second daycare business. The debtors owned the location of the original daycare center, and had leased a second location in hope of expanding their business. The attempt proved to be unsuccessful. Instead, the new leased location lost money and the original daycare center was supporting both locations financially. The Smelleys closed the leased location prior to the filing of their bankruptcy petition. Lisa Smelley testified that the failure of the leased daycare center was the precipitating cause of the bankruptcy filing, not Brown's 2004 lawsuit. The debtors' schedules reflected approximately $22,000.00 in unsecured debt owed to other creditors than Brown; approximately $5,000.00 in secured debt on personal property; and approximately $557,000.00 in debt secured by the Smelleys' residential and business real estate.

The debtor Lisa Smelley testified that the schedules, as amended, were accurate. She testified that they reflected all actual income and expenses; all real and personal property; and all creditors. She did testify that the original schedules had inaccuracies because they were prepared hastily in

order to file the petition prior to the October 17, 2005 effective date of the amended Bankruptcy Code. The amended code created new burdens and expenses for debtors filing bankruptcy petitions, as well as making prepetition debts for fraud nondischargeable for individuals in Chapter 13, as well as in Chapter 7.

Additionally, the debtor testified that the schedules I and J reflecting income and expenses, as originally filed, were based upon her projected estimate of income and expenses the Smelleys would have after consolidating operations into one daycare location. On the other hand, Smelley said amended Schedules I and J, filed April 10, 2006 (BK Docs. 67 and 68), reflected the actual income and expenses of the one-center daycare operation after months in operation. There was no evidence that the schedules, as amended, were inaccurate. A comparison of the original schedules with the amended schedules shows that the updated income and expense statements are the only material changes in the new schedules.

Lisa Smelley testified that neither she nor her husband, Jerry Luther Smelley, Jr., had filed a prior bankruptcy petition. She testified that the restructured daycare center was generating sufficient funds to pay all creditors 100% over five years, and that the amended plan reflected this change in financial circumstances.

Chapter 13 Trustee C. David Cottingham questioned the debtor about the actual feasibility of the plan, a requirement under 11 U.S.C. § 1325(a)(6). In answer, Lisa Smelley testified that the current daycare center has a permit for 82 children. The Smelleys have between 75 and 80 children now, with approximately 10% of these children paid for by the state at the rate of $70.00 per week. Approximately 90% of the children are private clients, paying $90.00 per week. She further testified that the daycare center had seven full-time employees, and two part-time employees. The debtor

testified that the Smelleys would increase their proposed plan payment to $800.00 per month, which would be sufficient to pay 100% to unsecured creditors, and to pay all secured creditors at the proposed plan rate of interest.

Based on the amendments to the schedules and the oral agreement to increase plan payments to $800.00 per month, the Chapter 13 trustee announced that he would withdraw his motion to dismiss the case. He recommended confirmation of the plan with a payment of $800.00 per month.

At the close of the hearing, the court took Brown's remaining objection to confirmation under submission for a decision.

CONCLUSIONS OF LAW

The court has jurisdiction of the Smelleys' Chapter 13 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this lawsuit, a core bankruptcy proceeding pursuant to 28 U.S.C. § 157(a), under 28 U.S.C. § 1334(b). Jurisdiction is referred to this Bankruptcy Court by the General Order of Reference of the United States District Courts for the Northern District of Alabama signed July 16, 1984, As Amended July 17, 1984.

I.

Determining "good faith" in the meaning of 11 U.S.C. § 1325(a)(3) requires an analysis of the circumstances of each case.

11 U.S.C. § 1325(a) provides that a bankruptcy court "shall confirm" a Chapter 13 debtor's proposed reorganization plan if certain conditions have been met, with the debtor bearing the initial burden of showing compliance with the statutory requirements. An objecting creditor may challenge confirmation by offering evidence refuting the initial showing.

The requirement still in issue after the April 10, 2006 hearing is stated at Section 1325(a)(3).

That section provides the following:

(a) Except as provided in subsection (b), the court shall confirm a plan if – ...

... (3) the plan has been proposed in good faith and not by any means forbidden by law; ... (emphasis added)

Since the code does not define good faith or provide objective criteria for determining its existence, a majority of courts have applied a "totality of the circumstances" analysis to this dispute. In the Eleventh Circuit, that analysis is conducted under the framework provided by Kitchens v. Georgia Railroad Bank and Trust Company, et al. (In re Kitchens), 702 F.2d 885 (11th Cir. 1983). The Kitchens factors for determining good faith can be summed up as follows:

1. The amount of the debtor's income from all sources; 2. Living Expenses of the debtor and dependents; 3. Amount of the attorney's fees; 4. Probable or expected duration of the debtor's Chapter 13 plan; 5. Motivations of the debtor and his sincerity in seeking relief under the provisions of Chapter 13; 6. The debtor's degree of effort; 7. The debtor's ability to earn and likelihood of fluctuation in his earnings; 8. Special circumstances such as an inordinate medical expense; 9. Frequency with which the debtor has sought relief under the Bankruptcy Reform Act; 10. Circumstances under which the debtor contracted his debts and his demonstrated bona fides, or lack of same, in dealings with his creditors; 11. The burden which the plan administration would place on the trustee; 12. The type of debt to be discharged and whether such debt would be dischargeable under Chapter 7; 13. The accuracy of the plan's statements of debts and expenses and whether any inaccuracies are an attempt to mislead the court; and 14. The extent to which the claims are modified and extent of preferential treatment among classes of creditors.

See Kitchens, 702 F.2d at 888-889.

As stated by the Eleventh Circuit court: "The factors we have explicitly mentioned are not intended to comprise an exhaustive list, but they should aid bankruptcy courts as they determine whether debtors have proposed chapter 13 plans in good faith." This basic approach, adopted in 1983, is still used by lower courts in the Eleventh Circuit, with the case-by-case analysis producing different conclusions based on the fact evidence.

II.

There is no evidence showing that the Smelleys proposed their amended Chapter 13 plan in bad faith.

The court will review each of the Kitchens factors in relation to the evidence in this case:

1. **The amount of the debtors' income from all sources**: The debtors presented testimony and amended Schedule I to reflect the gross income currently received from the Smelleys' daycare center at approximately $22,000.00 per month. There was no evidence that the debtors have any other source of income or that this amount was not correct.

2. **Living expenses of the debtor and dependents**: The debtors submitted their amended Schedule J reflecting both their household expenses and the current operating expenses of the daycare center. There was no evidence that these expenses were incorrect.

3. **Amount of attorney fees**: The debtors' plan proposed attorney fees in the amount of $1,800.00, which is reasonable for a case of this nature.

4. **Probable or expected duration of the debtors' chapter 13 plan**: The debtors' proposed plan was for a term of 60 months, the maximum time allowed by law.

5. **Motivations of the debtor and his sincerity in seeking relief under the provisions of Chapter 13**: The debtor testified that this petition was filed as a result of the failed daycare center expansion, not the lawsuit pending in Tuscaloosa County Circuit Court. The lawsuit had been pending for approximately 2 years, and there was no evidence that this petition was filed on the eve of any scheduled trial date, or other critical proceeding.

6. **Debtor's degree of effort**: The debtors have proposed submitting all their disposable income to the trustee for 60 months in order pay their plan creditors.

7. **The debtor's ability to earn and likelihood of fluctuation in his earnings**: The debtors presented evidence of the capacity of their daycare center, the income it earns, and its expenses. There was no evidence suggesting major fluctuations in expenses or earnings in the future.

8. **Special circumstances such as an inordinate medical expense**: This was not a factor in the Smelley case.

9. **Frequency with which the debtor has sought relief under the Bankruptcy Reform Act**: This was the first bankruptcy filing for either debtor.

10. **Circumstances under which the debtor contracted his debts and his demonstrated bona fides, or lack of same, in dealings with his creditors**: Brown has alleged that her claim against the

debtor Lisa Smelley resulted from fraudulent conduct. There is no suggestion that the debtor Jerry Smelley engaged in any fraudulent conduct.

11. **The burden which the plan administration would place on the trustee**: There was no evidence that this plan would create any unusual burden for the trustee. The trustee has recommended its confirmation.

12. **The type of debt to be discharged and whether such debt would be dischargeable under Chapter 7**: Under former law, this issue has been important for analyzing good faith in "percentage" Chapter 13 plans where some unpaid, nondischargeable debts might be discharged. However, the Smelleys' plan proposed to pay 100% to all creditors. While unsecured debts stemming from fraud could be discharged in Chapter 13, an alleged fraudulent debt would nevertheless be paid in full in a 100% plan. Brown's claim would have been due payment in full in the Smelleys' Chapter 13, if her claim had been timely filed.

13. **The accuracy of the plan's statements of debts and expenses and whether any inaccuracies are an attempt to mislead the court**: There did not appear to be any material inaccuracies in the schedules as amended, and there was no evidence that the Smelleys attempted to mislead the court.

14. **The extent to which the claims are modified and extent of preferential treatment among classes of creditors**: There does not appear to be any preferential treatment among classes of creditors because the plan proposed to pay all allowed claims in full.

The presence or absence of any of the above factors is not per se determinative of whether or not a plan is filed in good faith. The fact that the debtors attempted to discharge a debt in a Chapter 13 case which would be nondischargeable in a Chapter 7 case alone does not result in a finding that the plan was not proposed in good faith. See State of Ohio Student Loan Commission v. Doersam (In re Doersam), 849 F.2d 237, 239-40 (6th Cir. 1988); Hardin v. Caldwell (In re Caldwell), 895 F.2d 1123, 1128 (6th Cir. 1990); In re White, 273 B.R. 279, 283 (Bankr. M.D. Fla. 2001); and In re Griggs, 181 B.R. 111, 115 (Bankr. N.D. Ala. 1994).

The evidence does not indicate that this bankruptcy petition was filed because of Brown's suit. That action had been pending for approximately two years on the petition date. The evidence before the court showed that the Smelleys sought bankruptcy protection only after the failure of the

expansion of the daycare business. The debtors' schedules also included substantial debt to creditors other than Brown.

It appears to the court that Brown's dissatisfaction with this amended 100% Chapter 13 plan stems from the fact that she cannot be paid as an allowed unsecured creditor under its provisions. That is not due to any action or inaction by the debtors.

The debtors correctly listed Brown as a creditor and the court provided her with notice of the February 15, 2006 deadline for filing claims. Brown did not object to confirmation of the debtors' original plan which proposed no distribution to her at all. Nor did she object to confirmation of this amended 100% plan until after the bar date had run. There is no evidence that the debtors did anything to prevent the creditor from filing a claim by February 15, 2006. After the claim was filed late, the debtors did object, as allowed by 11 U.S.C. § 502(b)(9). The debtors' exercise of a statutory right cannot be viewed as evidence of bad faith. After a March 28, 2006 hearing, the court disallowed the Brown claim as tardily filed. Consequently, Brown is not an allowed unsecured creditor to be paid in this 100% plan solely because she did not file a proof of claim by February 15, 2006, the last day for doing so under the Bankruptcy Code. The creditor's failure does not reflect on the debtors' motivations for Chapter 13 reorganization.

The court, having considered the totality of the circumstances in this case, must find that the Smelleys made an adequate showing that their Chapter 13 plan complied with 11 U.S.C. § 1325(a), including the good faith requirement of Section 1325(a)(3); and that objecting creditor Marie S. Brown failed to refute that evidentiary showing.

CONCLUSION

Consequently, the court must **CONFIRM** the Smelleys' Chapter 13 plan as amended, and

OVERRULE Brown's objection to confirmation. As previously noted, the trustee withdrew his motion to dismiss the case, and recommended confirmation of the 100% plan with a payment increased to $800.00 per month.

An order, consistent with these findings pursuant to Fed. R. Bankr. P. 7052, will be entered separately.

DONE and ORDERED this June 16, 2006.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

FRANKLIN TRANSPORTATION, INC., **BK 03-71309-CMS-7**

DEBTOR.

AP 05-70014-CMS

ROBERT A. MORGAN, as TRUSTEE,

PLAINTIFF,

vs.

BANK OF MOUNDVILLE,

DEFENDANT.

MEMORANDUM OF DECISION

This action was set for hearing on a motion for summary judgment by The Bank of Moundville (Bank)(AP Doc. 25) and on the trustee's cross-motion for summary judgment (AP Doc. 32). The court will treat the trustee's cross-motion as a response in objection to the Bank's motion for summary judgment**.** The court has reviewed the facts in the context of applicable law and finds that the Bank's motion is due to be **DENIED**, in part; and **GRANTED**, in part. The trustee's objection is due to be **SUSTAINED**, in part; and **OVERRULED,** in part.

FINDINGS OF FACT

Chapter 7 Trustee Robert A. Morgan's original complaint in this adversary proceeding alleged that the Bank received preferential transfers under 11 U.S.C. § 547 and fraudulent transfers under 11 U.S.C. § 548. The lawsuit asked the court to set aside and award to the estate a total of $36,514.90 in payments made in the 90 days prior to the debtor's April 24, 2003 Chapter 11 filing.

Exhibit F1 to the trustee's brief (AP Doc. 33) later itemized alleged preferential transfers totaling $41,330.66, an amount greater than the amount listed in the complaint. The corporate case was converted to a Chapter 7 liquidation on July 10, 2003. (BK 03-71309, Doc. 29), and Morgan was appointed trustee that same day. (BK Doc. 31)

On July 7, 2003, corporate officers Gary C. Franklin and Emilie J. Franklin had also filed an individual Chapter 7 case.(BK 03-72116) Morgan was also appointed trustee in that case. The individual debtors were discharged on October 16, 2003 (BK Doc. 17), and Morgan filed his report of no distribution in a "no asset" case on April 18, 2006 (BK Doc. 19). The case has not been closed yet, but it has little relevance to this separate dispute between a corporate creditor and Morgan in his role as trustee for all corporate creditors in BK 03-71309.

The facts, as alleged in the Bank's motion for summary judgment and the trustee's cross-motion/response do not appear to be in dispute.

Debtor Franklin Transportation, Inc. had entered into three loan agreements with the Bank prior to the filing of its bankruptcy petition. The first loan was for $1.1 million (loan number 996513). It was entered into on March 5, 2002, and stated that it is secured by a real estate mortgage recorded September 5, 2001; and by personal guarantees. (Exhibit A2 to trustee's brief in support of cross-motion for summary judgment, AP Doc. 33). It is undisputed that the real estate securing the loan was owned solely by corporate officers Gary C. Franklin and Emilie J. Franklin, as individuals. Loan number 996513 in trustee's Exhibit A2 showed that it was a renewal of a prior note number 988839, with a maturity date of March 5, 2017. This note provided for monthly payments of $9,138.30 subject to adjustment based upon the variable interest rate provided for in the loan.

A second note in the amount of $50,000.00 is identified as loan number 1007823 dated March 13, 2003 with a maturity date of September 9, 2003. This loan in the amount of $50,000.00 was a renewal of a prior loan 1001965. (Exhibit A12 to trustee's brief in support of cross-motion for summary judgment) This was a single installment note with payment in the amount of $51,726.03 being due August 9, 2003. This loan also was secured by a mortgage on the same real estate owned by Gary and Emilie Franklin.

A third loan in the amount of $50,000.00 was designated as loan number 997084 and was entered into March 27, 2002 with a March 27, 2017 maturity date (Exhibit A17 to trustee's brief in support of cross-motion for summary judgment). This note provided for monthly payments of $415.38 subject to adjustment for the variable rate of interest provided for in the loan. This loan was also secured by Gary and Emilie Franklin's real estate.

There was no dispute that the real estate made the subject of the above described mortgages was owned by the Franklins individually. And there was no dispute that the mortgages were duly recorded.

Morgan filed this adversary proceeding against the Bank of Moundville on April 21, 2005. The Bank filed its **DEFENDANT'S MOTION FOR SUMMARY JUDGMENT** (AP Doc. 25) on April 21, 2006. The trustee filed his CROSS MOTION FOR SUMMARY JUDGMENT (AP Doc. 32) and **BRIEF IN SUPPORT OF CROSS MOTION FOR SUMMARY JUDGMENT** (AP Doc. 33) on May 22, 2006.

The parties appeared at a hearing on the Bank's motion for summary judgment and the trustee's opposition June 15, 2006. The parties agreed that the court should take the issues under submission based on the record at the close of the hearing.

CONCLUSIONS OF LAW

The court has jurisdiction of debtor Franklin Transportation, Inc.'s main bankruptcy case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of the trustee's lawsuit, a core bankruptcy proceeding under 11 U.S.C. § 157(b)(2)(F), pursuant to 28 U.S.C. § 1334(b). Jurisdiction is referred to this Bankruptcy Court by the General Order of Reference of the United States District Courts for the Northern District of Alabama, signed July 16, 1984, As Amended July 17, 1984.

Summary judgment motions are governed by Fed. R. Civ. P. 56, as applied in Bankruptcy Court by Fed. R. Bankr. P. 7056. Summary judgment is proper under Rule 56(c) "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."

As the Supreme Court of the United States stated in Celotex Corporation v. Catrett, 477 U.S. 317, 322-23 (1986):

> In our view, the plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. In such a situation there can be "no genuine issue as to any material fact," since a complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial.

Further, as stated in Ajaka v. BrooksAmerica Mortgage Corporation, 2006 WL 1765425, *2, n. 6 (11th Cir. 2006):

> Courts must construe the facts and draw all inferences in the light most favorable to the nonmoving party and "when conflicts arise between the facts evidenced by the parties, we credit the nonmoving party's version." Evans v. Stephens, 407 F.3d 1272, 1278 (11th Cir. 2005).

Since this is the Bank's motion for summary judgment, the court will construe all facts in the light

most favorable to the non-moving trustee's position.

I.

The bank has failed to show conclusively that it has a defense preventing the trustee from avoiding alleged preferential payments under 11 U.S.C § 547(b).

11 U.S.C. § 547(b) sets out the elements a trustee must show to prove that a prepetition transaction comprised an avoidable preference. The Bank, in its motion for summary judgment, asserted that the trustee could not show all these elements in the challenged payments it received from the debtor. The Bank also contended that it had Section 547(c) defenses to protect the payments from avoidance. It sought summary judgment in its favor on these bases.

Section 547(b) provides the following:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made –
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider;
>
> and
>
> (5) that enables such creditor to receive more than such creditor would receive if –
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

A review of each of the sections individually in the context of this record shows the following:

- **"Any transfer of an interest of the debtor in property"**: There is no fact dispute that there was a transfer. The debtor paid the Bank of Moundville with checks from accounts in the

name of the debtor, transfers of an interest of the debtor in property.

- **"To or for the benefit of a creditor"**: There is no dispute that the Bank was a creditor and benefitted from the receipt of Franklin Transportation, Inc.'s payments.

- **"For or on account of an antecedent debt owed by the debtor before such transfer was made"**: There is no dispute that the debts owed to the Bank by the debtor preceded the date of payments.

- **"Made while the debtor was insolvent"**: Section 547(f) provides that "for the purposes of this section, the debtor is presumed to have been insolvent on and during the ninety days immediately preceding the date of the filing of the petition. (emphasis added)" The alleged preferential transfers occurred within 90 days of the filing of the petition and the Bank has shown nothing indicating that the debtor was not insolvent.

- **"Made (A) on or within 90 days before the date of the filing of the petition..."**: All transfers were within 90 days of the filing of the bankruptcy petition.

- **"... That enables such creditor to receive more than such creditor would receive ..."** in a Chapter 7 distribution if the payments had not been made**:**

This element, Section 547(b)(5) is the heart of this contested matter, and the most complicated part of the preference determination. Although the material facts are not in dispute, the parties have argued opposite legal conclusions based on the same facts. In order to analyze under the Section 547(b)(5) "liquidation test", it is necessary to undo the prepetition transfers, meaning that checks paid to the Bank would hypothetically be returned to the debtor.

In that scenario, the indebtedness due to the Bank at the hypothetical Chapter 7 filing would be increased by $41,330.66 in alleged preferential payments (Exhibit F1 to trustee's brief in support of cross-motion for summary judgment) to a total of $1,200,133.15 from $1,158,802.49 (see Exhibit A1 to trustee's brief in support of cross-motion for summary judgment) At the time of filing of the hypothetical Chapter 7 petition, Franklin Transportation, Inc., would owe the Bank approximately $1.2 million, a debt secured by a mortgage on real estate not owned by Franklin Transportation, Inc.

In the chapter 7 context, the first question to be addressed is the status, or classification, of the bank's claim against Franklin Transportation, Inc. 11 U.S.C. § 506(a) sets out the extent to which a creditor's claim is secured – or unsecured – within the meaning of the Bankruptcy Code. Section 506(a) provides the following:

> **Section 506. Determination of secured status**
>
> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest. (emphasis added)

The undisputed facts in this case are that the real estate was not the property of Franklin Transportation, Inc., and that "the value of such creditor's interest in the estate's interest in such property" was zero. As is not uncommon in small business transactions, the corporation was liable for a loan secured by a consensual lien on property owned by others. Therefore, the Bank would be an unsecured creditor holding a $1.2 million unsecured claim against the corporation in a Chapter 7 case.

Whether or not the Bank could have received the full amount of its debt by the liquidation of the officers' individually owned property is not the issue in this particular lawsuit filed in this particular corporate debtor's case.

As stated in Virginia-Carolina Financial Corporation v. Creative Financial Management, Incorporated (In re Virginia-Carolina Financial Corporation), 954 F.2d 193, 199 (4th Cir. 1992), a similar fact situation:

> As the plain language of Section 547(b)(5) conveys, the court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead upon whether the creditor would have received less than a 100% payout in a Chapter 7 liquidation.

See also Committee of Creditors Holding Unsecured Claims v. Koch Oil Company (In re Powerline Oil Company), 59 F.3d 969, 972 (9th Cir. 1995), cert. denied 516 U.S. 1140 (U.S. 1996).

The Bank therefore received $41,330.66 in 90-day payments, reducing what would have been a $1.2 million unsecured claim in the hypothetical Chapter 7, to an approximate $1.16 million unsecured claim. It would also be entitled to receive a pro rata share of the remaining balance of its unsecured claim in Chapter 7, along with Franklin Transportation, Inc.'s other unsecured creditors. Further, the $41,330.66 in payments to the bank within the 90 days prior Chapter 7 reduced the assets available to pay other creditors. "It is the ultimate aim of the preference law in the Bankruptcy Code to insure that all creditors receive an equal distribution from the available assets of the debtor."Gill v. Winn (In Perma Pacific Properties), 983 F.2d 964, 968 (10th Cir. 1992). See also Southmark Corporation v. Grosz (In re Southmark Corporation), 49 F.3d 1111, 1117 (5th Cir. 1995).

Therefore, an analysis of the facts in the light most favorable to the trustee, has shown that the debtor Franklin Transportation, Inc., did make Section 547(b) preferential transfers to the Bank of Moundville within 90 days of the bankruptcy filing. The court clearly cannot grant summary judgment as a matter of law on the ground that the trustee has failed to show the elements of Section 547(b) preferential payments.

The Bank, in its motion for summary judgment, further asserted that, if the court found the payments were preferential under Section 547(b), the trustee still could not avoid the transfers because of defenses allowed a creditor under Sections 547(c)(1) and (2).

Section 547(c)(1) is commonly referred to as the "contemporaneous exchange for new value" exception. The Bank's submissions in support of its motion for summary judgment provide nothing indicating exactly what exchanges were made for exactly what new value to the corporate debtor. The creditor cannot be entitled to summary judgment on this defense.

Section 547(c)(2) is referred to as the "ordinary course of business defense". This bankruptcy case and adversary proceeding were filed prior to the 2005 amendments to the Bankruptcy Code and the applicable Section 547(c)(2) provides the following:

> (c) The trustee may not avoid under this section a transfer–
>
> (2) to the extent that such transfer was –
>
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms; ...

In support of the Section 547(c)(2) defense, the Bank submitted the affidavit of Sam Parks, an officer at First National Bank of Central Alabama. While the affidavit tracks the language of 547(c)(2), it is a mere conclusory statement without any factual basis in this record. The affidavit stated that the payments were on a debt incurred by the debtor in the course of ordinary business, but does not offer specifics on the type of debt it was, or how it related to the corporate debtor's business. The affidavit said that the payments were made in the ordinary course of business of the debtor, without stating what payments it refers to or what is ordinary for the debtor. It also asserted that the payments were made according to ordinary business terms, but does not state what those ordinary business terms consist of.

Therefore, interpreting this affidavit in a manner most favorable to the trustee upon this

motion for summary judgment, the bank has not met its burden that these transfers were in the ordinary course of business. The Bank is not due judgment as a matter of law under Section 547(c)(2).

Questions of material fact on both Section 547(c) defenses remain in issue, and the matter cannot be resolved by summary judgment on this record.

II.

The trustee cannot meet the threshold requirement to proceed under Section 548, and summary judgment is due to be granted as to this claim.

Trustee further asserted in his complaint that the transfers from the debtor to the Bank should be set aside as fraudulent transfers within the meaning of 11 U.S.C. § 548. The trustee's action is premised upon Section 548(a)(1)(B), referred to as the "constructive" fraudulent transfer section. Section 548(a)(1)(B) specifically provides that trustees may avoid transfers in which the debtor:

> (B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation (emphasis added); and
>
> (ii)
>
> (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

No proof of specifically fraudulent intent is required for a trustee to avoid a transfer as "constructively" fraudulent if all elements of Section 548(a)(1)(B) do exist in the transaction. The trustee's basic assertion under Section 548 is that the debtor received less than a reasonably equivalent value in exchange for the transfers made to the Bank. A finding of "less than a reasonably

equivalent value" is the threshold requirement for the rest of the constructive fraud analysis.

Section 548(d)(2) defines value:

> "value" means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor; (emphasis added)

Trustee's Exhibits A2, A12, and A17 show that the debtor Franklin Transportation, Inc., was itself indebted to the Bank, along with its officers. Therefore, Franklin Transportation, Inc., did receive value in the meaning of 548(d)(2). To the extent that the debtor transferred its funds to the bank, it reduced its own unsecured debt to Bank of Moundville dollar-for-dollar.

The trustee cited the Eleventh Circuit Court of Appeals' General Electric Credit Corporation of Tennessee v. Murphy (In re Rodriquez), 895 F.2d 725 (11th Cir. 1990). In General Electric Credit, the debtor corporation had paid debts it was not liable on for a separate subsidiary corporation. The Eleventh Circuit noted

> Since Domino (the debtor) was not liable for repayment of the International's indebtedness, Domino could not be found to have benefitted directly from repaying the loan absent a piercing of International's corporate veil. ...

General Electric Credit, 895 F.2d at 727.

Unlike the General Electric Credit case, the corporate debtor in the Franklin case was liable on the debt, along with its corporate officers. To the extent Franklin Transportation, Inc. paid its own debt, it did receive a benefit - "reasonably equivalent value" – reduction of the unsecured balance for which the corporation was liable. The fact that insiders may also have benefitted by the debtor's payments on its indebtedness does not mean that this corporate debtor received no value from the transfers.

This record conclusively shows that the trustee cannot meet the threshold requirement for the

court to find that the 90-day prepetition payments were in exchange for less than reasonably equivalent value. Consequently, the trustee's complaint on this issue cannot go forward, the record reflects all facts necessary to grant summary judgment in the bank's favor on the Section 548 allegation.

CONCLUSION

The court finds that the Bank's motion for summary judgment is due to be **DENIED** as to the charge that the payments can be avoided under Section 547(b), there remaining a question of material fact not resolved by these pleadings. However, the Bank's motion for summary judgment is due to be **GRANTED** as to the Section 548 constructive fraud claim since the existing record shows the trustee cannot proceed. To the same extent, Morgan's objection is due to be **SUSTAINED** as to the Section 547(b) claim of the complaint; and **OVERRULED** as to the Section 548 allegation.

An order, consistent with these findings pursuant to Fed. R. Bankr. P. 7052, will be entered separately.

DONE and ORDERED this July 19, 2006.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA,
WESTERN DIVISION

IN RE:

JERRY LUTHER and LISA GRAMMER SMELLEY, BK 05-73529-CMS-13

DEBTORS.

MEMORANDUM OF DECISION

This matter was before the court on Marie S. Brown's motions to set aside the court's order disallowing her late-filed claim in the Jerry Luther Smelley/Lisa Grammer Smelley Chapter 13 case. The court has reviewed the evidence and the written record in the context of applicable law, and finds Brown's motions must be **DENIED.**

FINDINGS OF FACT

This matter was set for hearing on May 25, 2006 on motions filed by Marie S. Brown (Brown) to set aside the court's prior order disallowing her claim as tardily filed (BK Doc. 64) and her motion to consider her objection to confirmation as an "informal proof of claim" (BK Doc. 65). These motions relate to the court's prior order entered March 31, 2006 (BK Doc. 57) following a hearing on the debtors' objection to the claim as untimely filed. The court found that Brown's Proof of Claim 14 was filed on February 17, 2006, after the February 15, 2006 deadline for filing claims.

Brown's motion to reconsider essentially asserted that her attorney prepared an objection to confirmation of the debtors' plan prior to January 23, 2006 and served a copy of this objection on Chapter 13 Trustee C. David Cottingham, the debtors' attorney, and attorneys representing debtor Lisa Smelley's codefendants in a pending state court lawsuit filed in 2004.

Brown, through her attorney, also asserted that her attorney attempted to file this objection to confirmation in the courtroom prior to a court hearing on confirmation of the debtor's plan scheduled on January 24, 2006 before the court convened the session. A member of the clerk's office who was in the courtroom, advised Brown's attorney that he would have to file his objection either electronically or on a diskette submitted to the Bankruptcy Clerk's Office. Brown's attorney asserted that another creditor's attorney had told him he could file his objection at the January 24, 2006 hearing. Brown's counsel conceded that he was not familiar with the Federal Rules of Bankruptcy Procedure or with local rules governing practice before the U.S. Bankruptcy Courts for the Northern District of Alabama. However, he also admitted that the member of the Bankruptcy Clerk's staff advised him of the rules three weeks prior to the February 15, 2006 claims deadline.

When Brown's attorney left the courtroom on January 24, 2006, he knew that Brown's objection to confirmation had not been filed. He was not under any mistaken belief that the pleading had actually been filed, or otherwise placed in the possession of the Clerk's Office.

Brown's attorney then filed electronically a proof of claim on behalf of Brown which was filed after the claims bar date.

The motions asked the court to first treat the January 24, 2006 objection to confirmation as constructively filed and then allow it to serve as an informal proof of claim filed before the bar date, which could then be amended by the proof of claim filed after the bar date.

Brown's attorney filed an affidavit in support of the motions (BK Doc. 77) essentially attesting to the facts asserted. There appears to be no dispute as to these facts. The same facts also existed, and were known to Brown's counsel, by the March 28, 2006 hearing on the debtors' objection to Brown's Claim No. 14. They were not presented to the court at that time.

There is no evidence that Brown's counsel went to the Bankruptcy Clerk's Office after leaving the courtroom or made any further attempt to file the proffered objection to confirmation, or a proof of claim in the three weeks between the hearing and the February 15, 2006 bar date. If he had proceeded to the Clerk's Office on the second floor, help would have been available to him there.

The Bankruptcy Court for the Northern District of Alabama provides a form for attorneys to use to request a waiver from the requirements of filing electronically, or by diskette. However, such forms and other written instructions for non-registered attorneys are not normally carried into the third floor courtroom where a motion docket is to be convened. There is no evidence Brown's counsel attempted any further contact to learn if he were eligible for a waiver, or how he might go about filing his objection.

There was no evidence that Brown's attorney did anything that appears in the docket record of the Smelley Chapter 13 until February 17, 2006 (two days after the bar date) when a claim was filed electronically on the creditor's behalf by another attorney appearing for the limited purpose of filing the proof of claim. On March 7, 2006, approximately three weeks after the bar date, an objection to confirmation of the debtor's new amended plan was filed electronically on Brown's behalf, again by another attorney.

Fed. R. Bankr. P. 3002(c) requires that creditors who wish to participate in a debtor's Chapter 13 plan must file claims "not later than 90 days after the first date for the meeting of creditors ..." In the Smelley case, the 90th day fell on February 15, 2006, two days before Brown's claim was filed. After the debtors objected, 11 U.S.C. § 502(b)(9) required the court to disallow the claim as "not

timely filed." (BK Doc. 51)

The court's equitable powers to allow a late-filed claim in Chapter 13 are limited to the narrow categories set out in Rule 3002(c)(1) to (5). After the March 28, 2006 hearing, the court disallowed the claim as untimely filed in the meaning of 11 U.S.C. § 502(b)(9), since it was not covered by any of the Rule 3002(c)(1)-(5) exceptions.(BK Doc. 57)

On April 7, 2006, the motions now in issue were filed with the court including a **MOTION TO SET ASIDE ORDER DISALLOWING CLAIM** (BK Doc. 64) and a **MOTION TO CONSIDER OBJECTION TO CONFIRMATION CONSTRUCTIVELY FILED** (BK Doc. 65). Brown, in essence, asked the court to vacate its prior order (BK Doc. 57).

At a May 25, 2006 hearing on BK Docs. 64 and 65, counsel for both sides offered some additional arguments, yet closed their cases with the evidentiary record as it stood at the end of the former March 28, 2006 hearing. Following the hearing, the court gave counsel for both parties time to file briefs before taking the issue under submission for decision on June 23, 2006.

On June 8, 2006, Brown's counsel filed a **BRIEF IN SUPPORT OF MOVANT'S MOTION TO SET ASIDE ORDER AND MOTION TO CONSIDER OBJECTION TO CONFIRMATION CONSTRUCTIVELY FILED** (BK Doc. 83). Brown's post-hearing brief expanded the arguments to broader constitutional grounds than previously pled or argued; and made reference to certain facts not in evidence. While these motions/briefings raise new facts/arguments, they do not alter the fact that Brown had filed nothing prior to the claims bar date. The Smelleys' counsel filed his **RESPONSIVE BRIEF IN OPPOSITION TO CREDITOR'S MOTION TO SET ASIDE ORDER DISALLOWING CLAIM** (BK 88) on June 21, 2006.

On June 23, 2006 as scheduled, the court took these issues under submission for decision.

CONCLUSIONS OF LAW

The court has jurisdiction of the Smelleys' Chapter 13 case pursuant to 28 U.S.C. § 1334(a). The court has jurisdiction of this contested matter, a core bankruptcy proceeding, under 28 U.S.C. § 1334(b). Jurisdiction is referred to the Bankruptcy Court by the General Order of Reference of the United States District Courts for the Northern District of Alabama, signed July 16, 1984, As Amended July 17, 1984.

I.

Brown's pleadings cited Fed. Rs. Bankr. P. 5005, 9029, and 9006. These rules cannot be helpful to the creditor, based on the particular facts in this case.

Rule 5005(a)(1) allows a court to consider pleadings which have been filed in a written format not in conformity with the local rules, if their substantive meaning is clear, and gives adequate notice. Rule 5005(a)(1) cannot apply here since Brown filed nothing, improperly styled or not, prior to the running of the bar date for claims.

The rule also provides that a bankruptcy judge "may permit" papers to be filed with the judge himself, the filing date noted, and "forthwith transmitted to the clerk." Brown's counsel did not make such a request after the courtroom was called to order and the record opened. The first reference to the alleged proffer in the record appears in the creditor's April 7, 2006 motions to reconsider.

That rule does direct "The clerk shall not refuse to accept for filing any petition or other paper presented for the purpose of filing solely because it is not presented in proper form as required by these rules or any local rules or practices." While Brown's attorney did approach a member of the

clerk's staff in the courtroom immediately before court convened and was advised of the local rule requiring electronic filing, he did not go to the clerk's office and inquire further as to what he should do to have his pleading filed.

Brown's motion also cited Fed. R. Bankr. P. 5005(b) on the filing and transmittal of papers. That rule provides:

> *Filing by Electronic Means*. A court may by local rule permit documents to be filed, signed or verified by electronic means that are consistent with technical standards, if any, that the Judicial Conference of the United States establishes. A document filed by electronic means in compliance with a local rule constitutes a written paper for the purpose of applying these rules, the Federal Rules of Civil Procedure made applicable by these rules, and § 107 of the Code.

That rule does not help Brown's case either.

Rule 9029 deals with the authority of the bankruptcy courts to promulgate local rules "when there is no controlling law." As the creditor has pointed out, Rule 9029(a)(2) does provide the following:

> A local rule imposing a requirement of form shall not be enforced in a manner that causes a party to lose rights because of a nonwillful failure to comply with the requirement. (emphasis added)

However, Rule 9029(b) also provides:

> **(b) Procedure When There is No Controlling Law.** A judge may regulate practice in any manner consistent with federal law, these rules, Official Forms, and local rules of the district. No sanction or other disadvantage may be imposed for noncompliance with any requirement not in federal law, federal rules, Official Forms, or the local rules of the district, unless the alleged violator has been furnished in the particular case with actual notice of the requirement. (emphasis added)

All of the rules governing this dispute are in complete compliance with federal law, federal rules, and the Local Rules of the Bankruptcy Court for the Northern District of Alabama. This Bankruptcy

Court for the Western Division of the Northern District follows no individualized chambers rules. It operates directly under "the federal law, the federal rules, the Official Forms, or the local rules." Additionally, the undisputed facts show that Brown's counsel had "actual notice" of the requirements three weeks prior to the February 15, 2006 deadline for filing proofs of claim according to counsel's own statements.

On May 7, 2004, the six bankruptcy judges serving the Northern District of Alabama executed an Administrative ORDER ADOPTING CASE MANAGEMENT/ELECTRONIC CASE FILING (CM/ECF) (Administrative Order No. 04-1) effective July 1, 2004. The Local Rule, Administrative Order No. 04-1, was entered and made enforceable in keeping with Fed. R. Bankr. P. 5005.

By the early spring of 2006, 90 of the 92 bankruptcy courts in the United States had implemented the CM/ECF system, and "The vast majority of those courts have made electronic filing mandatory for attorneys," an Oklahoma bankruptcy court stated in In re West, 338 B.R. 906, 908, n. 6 (Bankr. N.D. Okla. 2006).

The eight U.S. District Court judges in this district also signed a similar order, General Order No. 2004-01, adopting the CM/ECF, effective November 1, 2004, for the district courts above. Since the Bankruptcy Courts are units of the District Court, admission to practice before the U.S. District Court for the Northern District of Alabama, is a requirement for representing parties before this court as well.

Since the electronic requirements are so new, there is little case law interpreting the new procedure into the context of existing law and practice. In Florida's Southern District, the bankruptcy courts were requiring attorneys to file matrices in their cases on diskettes under Local Rule of

Bankruptcy 107 (C) by the mid-1990s. One attorney asked the court for permission to continue filing paper matrices because she was newly admitted to practice and had not bought a computer.

The Bankruptcy Court for the Southern District of Florida, sitting en banc, said no, suggesting she take her paper matrices to Kinko's before she attempted to file at the Bankruptcy Clerk's Office. The court stated in In re Noy, 203 B.R. 800 (Bankr. S.D. Fla. 1996):

> If the alternative (to diskette filing) in this case would require this attorney to spend thousands of dollars for installation of a computer system, the court would perhaps seek another alternative. An inquiry into the local public market place reveals that the attorney can take her paper matrix to the local Kinko's business center (a company which is apparently operating nation-wide throughout the United States) and rent the use of a computer at the rate of approximately $.20 per minute or $12 an hour. Other venders of secretarial support services offer similar pricing. Diskettes are available for sale at prices ranging from as little as $.50 to $1 or so each. This is a far cry from purchase of a computer system in the thousands of dollars and should prove little hardship to practitioners who are not yet ready to enter the computer era.

However, it is clear that compliance with the law and the rules is still required, whatever the technical tools required to do so. The results of technical failure on legal limitations periods can be harsh for both counsel and client. See In re West, 338 B.R. 906 (Bankr. N.D. Okla. 2006), (longtime bankruptcy lawyer sanctioned, admission to practice lifted, for repeated failures to comply with CM/ECF administrative order; and client's Chapter 13 case dismissed along the way); Askew v. Patel (In re Patel), 2006 WL 318613 (M.D. Ga. 2006) (district court reversed a bankruptcy court to find that a dischargeability lawsuit was "filed" when it appeared on the clerk's office electronic docketing system, the last day for filing; not two days later when paper copies of the complaint arrived in the mail); and In re Sands, 328 B.R. 614 (Bankr. N.D. New York 2005) (debtor lost her house because, while her bankruptcy counsel logged on to the court's CM/ECF system 15 minutes before foreclosure sale, the Chapter 13 petition was not actually filed with the Bankruptcy Court until it was docketed

electronically two hours after the auction).

The Bankruptcy Court for the Northern District of Alabama sponsored an extensive period of notification and training for attorneys who wished to register to file electronically prior to the July 1, 2004 effective date. Provision was also made for accepting disk filings from non-registered attorneys and for waivers. Complete information on the court's order and its procedures is, and has been, available on court's public website, www.alnb.uscourts.gov.; and from divisional Bankruptcy Clerk's Offices throughout the district.

Since the July 1, 2004 effective date of CM/ECF, all attorneys practicing the U.S. Bankruptcy Courts for Northern District and all "represented parties" have been required to file electronically or by diskette. Administrative Order No. 04-1 was also intended to limit "Conventional filing" (the old-fashioned, paper way) to parties appearing pro se. However, the order and the administrative procedure it adopted provide a waiver at Paragraph III(A)(4) for "Filers Without Ability to File by Computer Diskette", including some attorneys, to file "conventionally" by paper presentation at the divisional clerks' offices. A copy of the waiver form is available to attorneys in paper form in the offices; and in Administrative Order No. 04-1, as posted on the court's web site.

There is no evidence that Brown's counsel ever attempted a formal filing, other than late and electronically. Nevertheless, his statements show that the unnamed clerk gave him the right advice in the courtroom, "actual notice" of the rules in the meaning of Rule 9029(b), well before the bar date ran and the claim became unsalvageable by operation of law.

II.

The creditor's attorney also contended that the court should set aside its order on the authority of 11 U.S.C. § 9006(b)(1), and/or deem counsel's alleged pre-bar date proffer of the objection to

confirmation as an "informal proof of claim" in the meaning of Charter Company v. Dioxin Claimants (In re The Charter Company), 876 F.2d 861, 864 (11th Cir. 1989) and other cases. See contra United States of America v. International Horizons, Inc. (In re International Horizons, Inc.), 751 F.2d 1213, 1217-18 (11th Cir. 1985).

Brown's problem is not that the objection to confirmation was not filed. The plan the debtor had pending for confirmation and which Brown was attempting to object to was not confirmed at the January 24, 2006 hearing. Lack of an objection by Brown was not the problem. The problem is that Brown never filed or attempted to file a proof of claim until after the February 15, 2006 bar date. Brown needs the objection to confirmation considered to have been filed prior to the bar date in order to serve as an informal proof of claim which could then be amended by the late claim.

As set out in the challenged order, most decisions allowing informal proof of claims occurred in Chapter 11 cases. None of the cases suggest that non-record action by individual attorneys outside the knowledge of the court constitutes a "filing", constructive or actual, See International Horizons, Inc., 751 F.2d at 1217.

The deadline for proofs of claim in Chapter 13 is set by Rule 3002(c). Although Rule 9006(b)(1) does allow a bankruptcy court some equitable leeway to extend a lapsed deadline under some rules for "excusable neglect," the "excusable neglect" exception does not apply in Chapter 13 cases to late-filed claims under Rule 3002(c). Rule 9006(b)(3) specifically limits expansion of that time frame to exceptions set within Rule 3002(c) itself. Rule 9006(b)(3) provides:

> *Enlargement Limited.* The court may enlarge the time for taking action under Rules ... 3002(c) ... only to the extent and under the conditions stated in those rules. (emphasis added)

Rule 3002(c)[1], as it existed before the October 17, 2005 amendments, is applicable in this case. That rule stated its own narrow exceptions to the bar date it set. They included five categories of late-filed claims which courts could consider for allowance, including: governmental units; infants and incompetent persons; certain judgment debts (no unliquidated claims); claims created by the debtor's rejection of a lease; and Chapter 7 creditors when a trustee unearths undisclosed assets. Brown does not fit into any of these categories. Unlike time frames falling under Rule 9006(b)(1),

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[1] Rule 3002(c) provides the following:

> **Time for Filing.** In a chapter 7 liquidation, chapter 12 family farmer's debt adjustment, or chapter 13 individual's debt adjustment case, a proof of claim is timely filed if it is filed not later than 90 days after the first date set for the meeting of creditors called under S 341(a) of the Code, except as follows:
>
> (1) A proof of claim filed by a governmental unit is timely filed if it is filed not later than 180 days after the date of the order for relief. On motion of a governmental unit before the expiration of such period and for cause shown, the court may extend the time for filing a claim by the governmental unit.
>
> (2) In the interest of justice and if it will not unduly delay the administration of the case, the court may extend the time for filing a proof of claim by an infant or incompetent person or the representative of either.
>
> (3) An unsecured claim which arises in favor of an entity or becomes allowable as a result of a judgment may be filed within 30 days after the judgment becomes final if the judgment is for the recovery of money or property from that entity or denies or avoids the entity's interest in property. If the judgment imposes a liability which is not satisfied, or a duty which is not performed within such period or such further time as the court may permit, the claim shall not be allowed.
>
> (4) A claim arising from the rejection of an executory contract or unexpired lease of the debtor may be filed within such time as the court may direct.
>
> (5) If notice of insufficient assets to pay a dividend was given to creditors pursuant to Rule 2002(e), and subsequently the trustee notifies the court that payment of a dividend appears possible (as sometimes happen in Chapter 7 liquidation), the clerk shall notify the creditors of that fact and that they may file proofs of claim within 90 days after the mailing of the notice.

Rule 9006(b)(3) does not allow a court to extend a Rule 3002(c) bar for cause or parties' neglect, "excusable" or otherwise. See Pioneer Investment Services Company v. Brunswick Associates Limited Partnership, 507 U.S. 380, 389 (1993); and Midland Cogeneration Venture Limited Partnership v. Enron Corp (In re Enron) 419 F.3d 115 (2d Cir. 2005)

The majority of courts considering the issue in Chapter 13 have declined to extend the bar date under any other equitable theory. See Zidell, Inc. v. Forsch (In re Coastal Alaska Lines, Inc.), 920 F.2d 1428, 1432 (9th Cir. 1990); In re Greenig, 152 F.3d 631, 634 (7th Cir. 1998); Vicenty v. Sandoval (In re Sandoval), 327 B.R. 493, 512 (1st Cir. BAP 2005); Aboody v. United States (In re Aboody) 223 B.R. 36, 39-40 (1st Cir. BAP 1998); Americredit Financial Services v. Durham (In re Durham), 329 B.R. 899, 902 (Bankr. M.D. Ga. 2005); In re Jensen, 333 B.R. 906, 909 (Bankr. M.D. Fla. 2005); In re Roubert, 336 B.R. 22 (Bankr. D. Puerto Rico 2005) ; In re Husmann, 276 B.R. 596 (Bankr. N.D. Ill. 2002); In re Brogden, 274 B.R. 287 (Bankr.M.D. Tenn. 2001); In re Thomas, 181 B.R. 674, 677 (Bankr. S.D. Ga. 1995); In re Bloebaum, 311 B.R. 473 (Bankr. W.D. Tex. 2004); In re Griggs, 306 B.R. 660 (Bankr. W.D. Mo. 2004); In re Bourgoin, 306 B.R. 442 (Bankr. D. Conn. 2004); In re Boucek, 280 B.R. 533 (Bankr. D. Kan. 2002); and In re Wright, 300 B.R. 453 (Bankr. N.D. Ill. 2003).

A small minority of cases, nevertheless, have found some marginal "give" in the wording of the statutes and the rules. See In re Zwerling, 1985 WL 71914, * 2 (not reported in F.Supp.) (E.D. N.Y 1985) for a discussion of cases favoring extension in various circumstances. This court does not agree or disagree with these cases. The specific facts in the Brown/Smelley dispute required disallowance of the claim on narrower grounds. Those same facts control in the court's consideration of these motions to vacate.

III.

For even if the rules did allow expansion of the bar date, the movant has made no showing of any equitable reason, "excusable neglect" or otherwise, to vacate or alter the court's original order. Even if the court accepted all of Brown's alleged facts, as true; the order disallowing this claim would still have to stand.

Brown, the creditor, was represented by counsel as her agent from the outset of the case. The claim was disallowed because the affected creditor, through counsel, made conscious choices resulting in a late filing. The choices were made both before and after the January 24, 2006 hearing.

The creditor acknowledged that it received proper notice of the October 13, 2005 petition filing and of the February 15, 2006 bar date at the outset of this case. That notice also made counsel aware of the body of law and rules that would govern protection of Brown's interest in Bankruptcy Court. The creditor's own statement and argument established that counsel had actual knowledge of the specific local rule requiring electronic filing by January 24, 2006 – well before the bar date.

There was sufficient time between January 24, 2006 and February 15, 2006 for the creditor's counsel to acquire any additional knowledge, and/or any affiliation, needed to represent Brown. There was no overnight, emergency deadline here following short, surprise notice. Counsel had three weeks to take advantage of the certain help available to those seeking to file "conventionally" at the clerk's office. He did not avail himself of that help. Brown's attorney walked out of the courtroom on January 24, 2006 knowing that he had not filed a claim on behalf of Brown and knowing that his objection to confirmation had not been filed.

The court disallowed the late-filed claim because enlargement is not permitted by 11 U.S.C. § 502(b)(9), and Rules 3002 and 9006; and because there was no cognizable filing prior to the bar

date to which late filings could relate back as a "constructive" proof of claim. As stated in Pettle v. Bickham (In re Pettle), 410 F.3d 189, 192 (5th Cir. 2005):

> While Pioneer guides an analysis of "excusable neglect" within the context of Bankruptcy Rule 9006(b)(1), nothing in the Supreme Court's opinion changes the well-established rule that " 'inadvertent mistake"[,]... [g]ross carelessness, ignorance of the rules, or ignorance of the law are insufficient bases for 60(b)(1) relief. ... In fact, a court would abuse its discretion if it were to reopen a case under Rule 60(b)(1) when the reason asserted as justifying relief is one attributable solely to counsel's carelessness with or misapprehension of the law or the applicable rules of court." ...

It is the responsibility of counsel to know and abide by the properly enacted rules and statutes governing every court where counsel practices.

CONCLUSION

The court's order disallowing Brown's late filed Proof of Claim No. 14 must stand, and creditor's motions to vacate/set aside (BK Docs. 64 and 65) must be **DENIED**, there being no factual, legal or equitable basis on which to do otherwise. BK Doc. 57, the order disallowing Claim No. 14, will stand as entered on March 31, 2006.

A separate order, consistent with these findings pursuant to Fed. R. Bankr. P. 7052, will be entered separately.

DONE and ORDERED this August 3, 2006.

/s/ C. Michael Stilson
C. Michael Stilson
United States Bankruptcy Judge